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THE SCIENCE OF PUBLIC FINANCE



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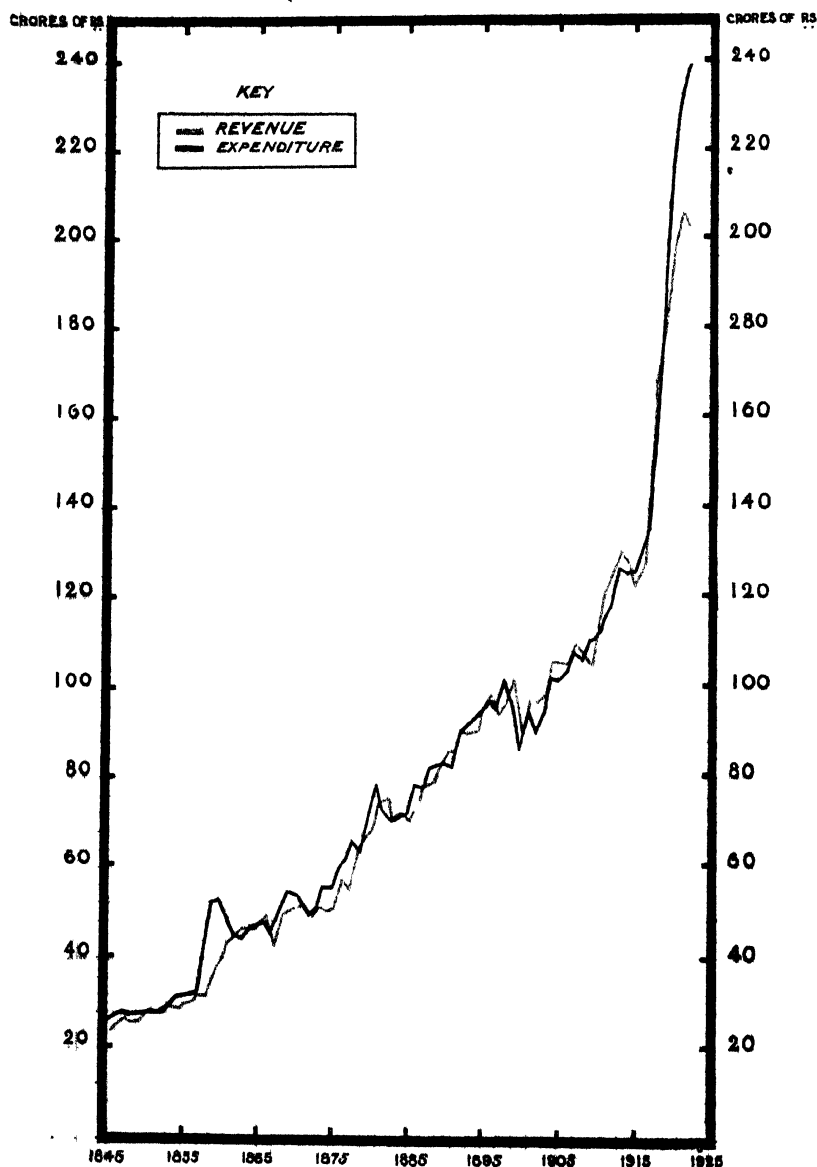
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THE BALANCING OF REVENUE AND EXPENDITURE.

REVENUE AND EXPENDITURE OF THE GOVERNMENT OF INDIA

(CENTRAL AND PROVINCIAL)



YEARS: YEAR LINE REPRESENT YEARS ENDING 30TH APRIL
FROM 1845 TO 1867 AND 31ST MARCH FROM 1868.

NOTE: IN A PERIOD OF 76 YEARS 39 YEARS OR 50 PERCENT.
WERE YEARS OF DEFICIT.

THE SCIENCE OF PUBLIC FINANCE

BY

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1924

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TO
MY OWN OLD UNIVERSITY
THE UNIVERSITY OF ABERDEEN
AND
ITS PRINCIPAL AND VICE-CHANCELLOR
SIR GEORGE ADAM SMITH
D.D., LL.D., D.Litt., F.B.A.

PREFACE

THE necessity of an up-to-date text-book on the science of public finance for the use of colleges and universities has been generally recognised.

Since the outbreak of the Great War, nearly a decade ago, great changes have taken place in the domain of the science. These changes have notably affected the views held regarding the canons of expenditure ; the burden and distribution of taxation ; taxable capacity ; expenditure from capital and from revenue ; the means of repayment of public debts, including such schemes as a capital levy. Many of the principles connected with these have received new importance in theory and practice. The years that have passed have been pregnant with grave issues and overshadowed by financial trials enough to daunt the bravest heart. But, throughout, the British Empire has shown initiative and strength, and has remained unwavering in its devotion to the ideals of sound public finance. The object of this work is to set out and to illustrate in the light of these recent changes the principles of public finance. Some countries have had to revise their ideas, others even their constitutions. India, for example, in 1919 was given a new constitution, but public finance, Federal and Provincial, seems to have received at the hands of the framers of the constitution not quite the treatment that so important an issue deserved. There are in India sources of revenue untouched, for example, inheritance taxes and the taxation of agricultural incomes.

Another inducement to undertake the work has been the desire to contribute something to the development of post-War financial rectitude at a time when countries are examining their financial systems, either from the point of view of economy and retrenchment, or from that of the real burden of taxation. The Chancellor of the British Exchequer announced in March last

the formation of a strong Committee under Lord Colwyn "to consider and report on the National Debt and the incidence of existing taxation, with special reference to their effect on trade, industry, employment, and national credit". In India, too, a similar inquiry has been set on foot :

" (1) To examine the manner in which the burden of taxation is distributed between the different classes of the population, (2) to consider whether the whole scheme of taxation, Central, Provincial, and Local, is equitable and in accordance with economic principles, and if not, in what respects it is defective, (3) to report on the suitability of alternate sources of taxation, (4) to advise as to the machinery required for the imposition, assessment, and collection of taxes old and new, (5) to prepare rough estimates of the financial effects of the proposals, and (6) to include in the inquiry consideration of the Land Revenue only so far as is necessary for a comprehensive survey of the existing conditions ".

These are but two examples. The necessity of putting one's house in order is everywhere seen. It is hoped that this volume, including the many statistical tables, will be of some utility in such investigations.

It need hardly be stated that, as in my work on *Indian Finance and Banking*, the book is in no sense an official publication. The views expressed in the volume are my own personal ones, and for these neither the Government of India nor the Government of Bombay can be regarded as in any way responsible. One of the main aims has been to set out facts, and special care has been bestowed on the statistical data.

The book has, perhaps, been rather long on the stocks. It has not been written during what some people are pleased to regard as the ample leisure of official life, for, in India, the luxury of an eight-hour day, sweetened by golden moments of lettered ease, is almost non-existent, at any rate to the official at headquarters.

G. FINDLAY SHIRRAS.

BOMBAY, *August* 1924.

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ADDENDA

1. THE FUNDAMENTAL PRINCIPLES OF TAXATION (Chaps. XIII. and XIV.)

The question is not infrequently asked—Is the taxation system of this or that country satisfactory? Chapter XIV. on the Canons of Taxation will assist in answering this question. The various factors which go to make up a good tax system should be weighed carefully. Secretary Andrew W. Mellon of the United States Treasury has recently put it thus: “The problem of the Government is to fix rates which will bring in a maximum amount of revenue to the Treasury and at the same time bear not too heavily on the taxpayer or on business enterprises. A sound tax policy must take into consideration three factors. It must produce sufficient revenue for the Government; it must lessen, so far as possible, the burden of taxation on those least able to bear it; and it must also remove those influences which might retard the continued steady development of business and industry on which, in the last analysis, so much of our prosperity depends. Furthermore, a permanent tax system should be designed not merely for one or two years nor for the effect it may have on any given class of taxpayers, but should be worked out with regard to conditions over a long period and with a view to its ultimate effect on the prosperity of the country as a whole.” (*Taxation: The People's Business*; Macmillan, 1924.) Secretary Mellon is of course emphasising certain of the Smithian canons.

2. RAILWAY FINANCE (Chap. XXX.)

At the end of September 1924 the Indian Legislative Assembly agreed to the separation of the Railway Budget from the ordinary or general Budget of the Government of India. The Government is to receive the interest on the capital which it has invested in the railways, with the exception of the purely strategic lines, together with a fixed annual dividend of *one* per cent and a share of any surplus profits. The dividend is of course an accruing charge. If not paid in one year owing to temporary causes it must be paid in a following year. Government will be able to budget for a fixed sum from railways, and the railways will have a freer hand in disposing of the balance after meeting the statutory charges.

3. RAILWAY FINANCE (Chap. XXX.)

The German Railways have been transferred to a German Company (the Reichseisenbahn Gesellschaft) with a nominal capital of £1,300,000,000. It is the largest Railway Company in the world. The Government is a large shareholder holding £650 millions of fully paid ordinary shares (*vide* Sir William Acworth's articles, "Railways in Pledge," *Times*, 19th and 20th September 1924).

BOOK I
INTRODUCTION

CHAPTER I

THE SCOPE AND METHODS OF THE SCIENCE

1. OF the many difficult questions confronting public authorities none is more important than that of finance, because, unlike the others, it is a continuing question. Governments, indeed, are nowadays judged in the long run by their record in the management of the country's finances. The Great War was largely responsible for this. It quickened men's thinking in many ways, especially in regard to public finance; it made us recognise matters as of real urgency which had passed for being merely speculative; it placed many standing questions of policy in a wholly new light. It has enlarged the subject matter of the science of finance and laid a greater emphasis than in pre-War days on one or two branches of the subject, notably in regard to expenditure, taxation, and debt. We shall attempt in a brief and business-like way to deal with the principles of public finance, or as we shall call the subject matter of our study the science of public finance, which may be said to be concerned with the manner in which public authorities obtain their income and spend it. By public authorities are meant mainly Central or Federal Governments and Provincial or State Governments. It includes also local authorities such as municipalities, district boards, and councils. The science of public finance is the equivalent of what Germans call "*Finanzwissenschaft*", the knowledge or science of finance. The French use the convenient expression "*science des finances*" and the Italians similarly "*scienza delle finanze*". The specialised use of the term in the sense of the management of public expenditure and public income first came into use in France in the sixteenth century and spread to other countries. The French have

reserved the plural form, "les finances", for this application, while the singular denotes business activities in monetary affairs, *e.g.* "la haute finance". The main divisions of the study are: (1) public expenditure—public authorities must incur expenditure to carry on their business; (2) public revenue or income, because to meet this expenditure public authorities must have revenue or income; (3) public debts, because if revenue does not suffice to meet expenditure, borrowing has to be resorted to in order to make both ends meet; and (4) financial administration, which since the War has assumed a new importance. This last branch of the subject includes the details connected with (1) the framing of budgets, and (2) audit, audit being the check on the realisation of revenue against the demand, and the check on expenditure in accordance with prescribed rules. Financial administration also includes the financial work of the legislature. The right of voting supplies and controlling expenditure—the power of the purse—is different in different administrations, but the methods followed have a large effect on the efficient or inefficient working of a country's finances. It is necessary for the legislature to keep an eye over its steward, if the executive is the steward of the general public, in order to avoid inefficiency and waste.

2. In the preceding paragraph we have referred to the effect of the War on public finance. The War was a great teacher. During War time financial control was inevitably relaxed and the administration of finance departments the world over was marked by a certain lack of grip and strength, especially in regard to the control of expenditure. Things had to be done, and done quickly. Formulae and conventions had to be brushed aside and difficulties dealt with in hearty sword-and-buckler style. As a result of this there have been developments and adjustments in theory and practice in public finance that have made treatises of pre-War years somewhat out of date. It was clear that the subject matter of our study was no longer confined to what Colbert (1619–1683), the French financier, called "the art of so plucking the goose as to secure the largest amount of feathers with the least amount of squealing". The saying of Cicero that "silent leges inter arma" did not quite apply to public finance, as so much was achieved in these years. Moreover, the growing field of State activity and increased conscious-

ness of the spirit of nationality made a wider outlook inevitable. The British Parliament raised the question of retrenchment in public expenditure in 1921, and the Geddes Committee was appointed. Similar action was taken in India in 1922 by the appointment of the Inchcape Committee after the Legislative Assembly had discussed the question and recommended the appointment of the Committee. The necessity for providing for the repayment of debt has also increased the importance of that part of the subject known as taxable capacity. The work of Sir Josiah Stamp, for example, in this respect, is well known. In various countries since the War the legislature has shown a desire to impress on the executive the necessity of looking on the system of taxation as a systematic whole, and of examining the distribution of taxation and the principles on which it was based. An example of this may be found in the remarks of Mr. Ginwala, in the Indian Legislative Assembly on the 5th of March 1923, when he said : " What takes place in the office of the Honourable the Finance Member every year when he prepares the revenue side of the Budget I can well imagine. He sits in his chair. He has got three men generally with him. On his right is perhaps Mr. Cook, on his left is Mr. Ayyar, and in front of him Mr. Sim. Then he asks, ' How much do these people require ? ' They say, ' Oh, this year they want 80 crores¹ of rupees only from taxation '. ' Is that so ? What did they have last year ? ' ' 64 crores. ' ' Very well. Give me a copy of the Tariff Act, a copy of the Income Tax Act, and a copy of the Opium and the Salt Acts and a blue pencil. ' He takes the blue pencil in his hands and says, ' Here, 11 per cent on this. No. I will put 15 per cent. That will give us 2 crores. Is that not so, Mr. Cook ? ' ' Yes, approximately that. ' Mr. Sim then says, ' Income Tax has been rather sterile these last few years. We will try a little super tax on something, ' and he adds on something to the super tax. Then he goes through the Opium and Salt Acts, and the same process goes on until he thinks he has secured the additional sixteen crores. I submit that this is not the way in which, any longer, the Indian Budget ought to be prepared. Every country in the world has, at definite periods, undertaken an examination of the taxation of the country with reference to the taxable capacity of the people.

¹ 1 crore = 10 millions = £666,666.

They have got figures and they study all the conditions with reference to the requirements of the country. I maintain that though the Finance Department claims to know everything, they have got no data upon which they can determine the taxation with reference to the taxable capacity of the people. There, I submit, is the orthodoxy of the Budget.”¹

3. The relation of the science of public finance (or, as some writers prefer to call it, the science of finance) to the science of economics and to statistics has been frequently discussed, especially by German writers. It cannot be too often emphasised that public finance is part of the science of economics. Our subject presumes a knowledge of other branches of the subject of economics, especially with the theory of money and credit and also banking. Adam Smith, the father of the science of economics, in Book V. of *The Wealth of Nations*, deals with (1) “the expenses of the Sovereign or Commonwealth”; (2) “the sources of the general or public revenue of the society”; and (3) “public debts”. It is, therefore, not quite correct to say with Bastable that “an acquaintance with economic science is, it may be said, an indispensable part of the equipment of the student of finance”,² or with Adams, that “a sound policy of public finance must rest upon a thorough knowledge of political economy”.³ Public finance, or, as we now call it, the science of finance, has also an intimate relation with statistics. The groundwork is to a large degree based on full and accurate statistics. It was sometimes said that the English were the first to discover the secret that the War would be won, especially in

¹ *Legislative Assembly Debates*, vol. iii. No. 49 (Government Printing, India, Calcutta), p. 2981. [Compare also the Resolution in the Council of State on the 23rd July 1923 by the Honourable Sir Manakjee Dadabhoy, which reads as follows: “That an inquiry be made into the whole system of taxation in India with a view to its thorough revision on an economic, equitable, and scientific basis with special regard to the taxable capacity of the people”. The Executive Council of the Association of British Chambers of Commerce has addressed the British Prime Minister urging the appointment of a Royal Commission to review the whole question of national and local taxation with special reference to the cost of collection of various forms of taxation, the line of demarcation between national and local taxation, and the relative contribution to the national income of productive industries (the *Times*, 11/7/1923)]. According to the *Times* correspondent at Kingston, the Government of Jamaica are making similar inquiries. A special Commissioner from London was to arrive in September 1923 to inquire into these financial problems.

² *Public Finance* (London: Macmillan & Co.), 3rd edition, p. 10.

³ *The Science of Finance* (New York: Henry Holt & Co.), p. 5.

regard to food control and shipping, by statistics. The same might be said in regard to finance although, perhaps, to a less degree. Many of the conclusions or principles in succeeding chapters are based on the tables published in the appendices. It is not possible to cover all the details set out in these tables and in the "Civil Estimates" and similar financial publications. To do so would involve (in the text) a mass of statistics that would terrify and bewilder the inquirer and distract the reader from the broad facts that have to be understood. As the first and greatest of India's Finance Ministers¹ puts it: "Finance is not mere arithmetic; finance is a great policy. Without sound finance no sound government is possible; without sound government no sound finance is possible". The science of public finance should always be a great policy. It is wider than the science of statistics (in its earlier days known as political arithmetic²), but it could not do without statistics as, for example, in budgets or in estimating the distribution of taxation among the various classes in a state. Modern financial administration depends greatly on full and accurate statistics. The "Budget Estimates" followed by "accounts" or final figures in India are a case in point.

4. The question is sometimes asked as to the method to be followed in dealing with the subject matter of our study. The answer is simple. In other branches of Economics induction and deduction are complementary: they go hand in hand. They are, as Schmoller would say, "both needed for scientific thought as the right and left foot are both needed for walking".³ The inductive method is the method required for ascertaining, for example, important financial facts, and it is the method by which

¹ Right Honourable James Wilson (1805-1860), father-in-law of Walter Bagehot; editor of the *Economist* (1843-1859); Financial Secretary to the Treasury in the Aberdeen Coalition Ministry until March 1856; 1859, Vice-President of the Board of Trade until appointed Finance Member of the Council of the Governor-General, India, the first to hold this appointment. His predominating power, according to Bagehot, was his business-imagination.

² Vide Sir William Petty's (1623-1687) *Discourse on Political Arithmetick and Essays on Political Arithmetick*; also Davenant's *Political Arithmetick*. "By political arithmetick", says Davenant, "we mean the art of reasoning by figures upon things relating to Government. . . . The art itself is undoubtedly very ancient; but the application of it to the particular objects of trade and revenue is what Sir William Petty began. . . . He first gave it that name, and brought it into rules and methods" (Davenant, *Political Arithmetick*, Works, i. 128, 129).

³ Schmoller in the article on "Volkswirtschaft" in Conrad's *Handwörterbuch*.

the premises of the deductive method are secured and the results verified. The deductive method, on the other hand, is also of utility, as, for example, in regard to the ultimate effects of public expenditure and the incidence of taxation. Premises are selected, consequences deduced, and these consequences are verified by comparison with what is observed to occur. If, then, we assume that induction and deduction between them exhaust all the methods by which financial truths are ascertained, we may say that a combination of both methods is required in the study of public finance. Marshall well summarises the position when he says: "The function, then, of analysis and deduction in economics is not to forge a few long chains of reasoning, but to forge rightly many short chains and single connecting links. This, however, is no trivial task. If the economist reasons rapidly and with a light heart, he is apt to make bad connections at every turn of his work. He needs to make careful use of analysis and deduction, because only by their aid can he select the right facts, group them rightly, and make them serviceable for suggestions in thought and guidance in practice; and because, as surely as every deduction must rest on the basis of inductions, so surely does every inductive process involve and include analysis and deduction. Or, to put the same thing in another way, the explanation of the past and the prediction of the future are not different operations, but the same worked in opposite directions, the one from effect to cause, the other from cause to effect. As Schmoller well says, to obtain 'a knowledge of individual causes', we need induction; the final conclusion of which is indeed nothing but the inversion of the syllogism which is employed in deduction? . . . Induction and deduction rest on the same tendencies, the same beliefs, the same needs of our reason." ¹

5. It will be convenient to summarise the scope of the chapters that follow. After a brief account of modern financial theory (Chapter II.), the subject of public expenditure is discussed with its many problems, including the canons of financial propriety as applied to expenditure. It is unfortunate that hitherto the system of expenditure has not been analysed in such detail as it merited, since good finance consists as much in the

¹ *Principles of Economics*, by Marshall (London: Macmillan & Co., 1916), Appendix C, p. 773.

spending as in the collecting of revenue, and the guiding principle of financial policy is to avoid extremes. The system of expenditure ought to be viewed as a whole and an adjudication made on conflicting claims (Book II.). Next in order comes the nature of public revenue with the treatment of such subjects as the characteristics of a good revenue system, the measurement of taxable capacity, the distribution of taxation, and its cost and incidence. The various taxes, central or federal, provincial or State, and those of a purely local nature, are examined from the point of view of the well-recognised principles that the burden of and the relief from taxation should be spread over the greatest possible number of people in proportion to their capacity to pay. The need in some countries, as in India, of increased revenue for nation-building activities, such as primary education, is discussed with special reference to new sources of taxation for Provincial or State Governments, and also as in the case of inheritance taxes for Central or Federal Governments. The line of demarcation between Central or Federal, Provincial or State, and local taxation is also discussed (Book III.). The burden of debt, the central problem of public finance for years to come, is referred to in Book IV. The service of the English public debt, for example, requires double as much as the total pre-War Budget, and nearly one half of the post-War expenditure in 1923. The flank of the problem can only be turned by a systematic and careful policy of tackling the tremendous problem of internal and external debt. In Great Britain this has already been begun, as it has, too, in some other soundly financed States. At the time of the Armistice the floating debt of Great Britain was £1500 millions sterling, but by the middle of 1923 this had been reduced to £800 millions, £449 millions having been paid off since 1920, with the result that the country was rid of all its foreign debts except those due to America. All obligatory repayments of debt should be met out of revenue, and any surplus remaining should be divided between debt redemption and (to a less extent) remission of taxation. Governments must remember that borrowing is not a short cut to prosperity, and a policy of borrowing must be resisted, except for what can reasonably be regarded as productive expenditure. The arguments in favour of a steady reduction of debt, even at the cost of heavy sacrifice, are economically and socially unanswerable. The last book

(Book V.) deals with budgets, audit, and the financial work of the legislature in countries in various stages of self-government, such as India, the self-governing Dominions, and Great Britain. Nothing makes for greater inefficiency in any country than a Budget which refuses to balance. Credit cannot be maintained unless the Budget is balanced and unless some provision is made for the redemption of debt.

Finally, there are charts, and a collection of statistical tables containing the detailed data referred to in the text.

CHAPTER II

THE DEVELOPMENT OF MODERN FINANCIAL THEORY

1. In the widest sense of the term, modern financial theory may be said to have had its birth in the second half of the eighteenth century. Almost from its very beginning it was international in character, and this for three reasons. In the first place, it was the custom for men of culture to travel. Adam Smith, for example, resigned his chair of Moral Philosophy in the University of Glasgow in 1763 to become travelling tutor to the young Duke of Buccleuch, and visited Paris, Toulouse, Bordeaux, Montpellier, and Geneva. Nearly a year was spent in Paris and eighteen months in Toulouse. Hume, Adam Smith's great friend, after a twelve months' tutorship of Lord Annandale, visited in 1746, as Secretary to General St. Clair, the Courts of Vienna and Turin. In 1763 he accompanied Lord Hertford to Paris, and there met the future kings, Louis XVI. and Louis XVIII. Sir James Steuart, on the completion of his education in Edinburgh, went abroad according to custom, and travelled for years in the Netherlands, France, Spain, and Italy. A second reason for the cosmopolitan complexion of modern financial theory is the frequency with which books were translated into foreign languages. *The Wealth of Nations*, between its date of publication in 1776 and 1802, when the well-known Garnier translation was published in Paris, was translated at least on five occasions into French. Between 1776 and 1861 there were six German translations of the same work. Thirdly, the introduction of new taxes into a country's fiscal system requires a thorough examination of the working of these taxes elsewhere, often under different conditions. Before one is able to say, whether a real and personal property tax is suitable as

a provincial source of revenue in India a detailed study of American and also Swiss experience would be required. The economist, in short, in the domain of public finance, has to draw his facts from a wider field than that of the country in which he lives.

2. The commencement of modern financial theory dates from the publication of *The Wealth of Nations* in 1776. For over a quarter of a century before that date there were signs of the coming change. In 1748 one of the ablest thinkers of the eighteenth century, Montesquieu (1689–1755), published his *Spirit of Laws* (*L'Esprit des lois*), the thirteenth book of which deals with taxation. Adam Smith and his Scotch contemporaries, we know, studied Montesquieu with nothing short of veneration. He is the “Mr. Montesquieu” we meet with in *The Wealth of Nations*. He propounds the advantages of progressive taxation and the direct taxation of individuals after the satisfaction of their ordinary wants and not in proportion to their wealth. Montesquieu’s methodology must have appealed to Adam Smith. In 1752 appeared two essays, one on taxes and the other on credit, in *Political Discourses*, by David Hume (1711–1776). Hume’s contribution to financial theory is of interest and value because he belongs to a transition stage when economics had grown out of political philosophy but had not yet become a science. He denied the Physiocratic doctrine that all taxes ultimately fell upon the land, and believed those taxes to be best which are levied on consumption, especially those of luxuries, because they are least felt. In 1767 appeared Sir James Steuart’s *Principles of Political Economy*, in which public credit ¹ and taxes ² were separately discussed. A little unattractive in style and unsound in regard to the teaching of the moderate mercantilists, it fell, especially after the publication of *The Wealth of Nations*, almost into neglect. It is not even referred to nor quoted in *The Wealth of Nations*. “I have the same opinion of Sir James Steuart’s book that you have”, says Adam Smith in a letter to Pulteney (1772). “Without once mentioning it, I flatter myself that any false principle in it will meet with a clear and distinct confutation in mine.” Many German writers have estimated the work of Steuart exceedingly highly, and we may safely hold with Roscher that he was “a great economist” who

¹ Book IV. Part 4.

² Book V. •

was unduly overshadowed by Adam Smith, and especially by the latter's clear exposition. Steuart had good ideas on taxes, as is shown in the concluding book of his *Principles*. His other writings, such as *The Principles of Money applied to the Present State of the Coin of Bengal* (1772), are mainly concerned with money and, therefore, outside the scope of this work.

3. The economists or the Physiocrats¹ held tenets which would not be accepted by writers on the science of public finance to-day, but in the words of Adam Smith,² "it would not, surely, be worth while to examine at great length the errors of a system which never has done, and probably never will do, any harm in any part of the world". The treatment by this school of the incidence of taxation and the analysis of public revenue are of importance if only from the effect which was produced on Adam Smith and his contemporaries. Agriculture alone of all industries produces, according to the Physiocrats, more than the total sums advanced—the surplus being the *produit net*, at the expense of which all other industries exist. It is this *produit net* which supports all the weight of taxation. They believed in the superiority of the single tax on the *produit net* or net product of land—the *impôt unique*—while admitting the temporary use of other taxes. The best known are Quesnay (1694–1774), Gournay (1712–1759), the elder Mirabeau (1715–1789), Du Pont de Nemours (1739–1817), and the statesman Turgot (1727–1781). Quesnay was held in high esteem on account of his brilliant intellect and high character. It was only his death that prevented Adam Smith from dedicating to him *The Wealth of Nations*, and his fame as an economist was equal to that attained some years later by Adam Smith. His *Tableau économique* (1758) is quoted in *The Wealth of Nations* as one of the three great inventions that have contributed most to the stability of political societies, the other two being those of writing and money. Several of his maxims and his *Second problème économique* refer to finance. Turgot,³ in numerous

¹ A name invented by Du Pont de Nemours for his friends and himself. In 1799 he first employed the word "physiocrate". It was taken from the title of a collection of the works of Quesnay, published by Du Pont in 1767, *Physiocratie ou Constitution naturelle du gouvernement le plus avantageux au genre humain*.

² *Wealth of Nations*, Book IV, chapter ix, p. 161.

³ Turgot, *Œuvres de M. Turgot, ministre d'État* (Paris: A. Belin, 1811), 9 vols.

financial measures, showed great financial insight. After a ministry of twenty months he abolished twenty-three taxes onerous to commerce and industry, abolished the *corvée* on roads which cost the country four times as much as ordinary labour, and left a large surplus as compared with a deficit when he assumed office.¹

4. In the sphere of finance Adam Smith (1723-1790) co-ordinates all previous work. *The Wealth of Nations* is, perhaps, the best example in the world of the truth of Carlyle's saying that "books accomplish miracles. They persuade men." He combined theory and practice in outlining (in Book V. of *The Wealth of Nations*) with characteristic breadth, sympathy, and sincerity, the standpoints from which the field of finance has to be surveyed. His *magnum opus*, the fruit of twelve years of concentrated work, shows that he excelled in the "osteology" of finance. *The Wealth of Nations* was begun at Toulouse, and while in France he met Quesnay, Turgot, and other celebrities he most desired to know. To his French visit he owed much. His knowledge of French finance in Book V., where he compares the French system of taxation with the English, was without doubt due to his visit to France. His treatment of public expenditure, of public revenue, and of the principles of taxation precedes a criticism of various existing and proposed taxes, especially those in the English system. He judges these taxes by the canons which he has laid down, and illustrates his points with abundance of points from English and foreign practice. His chapter on public debts reminds one of what the wise Finance Minister of the first Napoleon, "le bon Mollien", said, "I avow to the shame of my first instructors" (*i.e.* the previous officials) "that it was the book of Adam Smith, then so little known, but which was already decried by the administrators with whom I had served, which taught me better to appreciate the multitude of points at which public finance touches every family, and which raised judges of it in every household".

Bagehot, in one of his best biographical essays, says that Adam Smith, the founder of the science of business, was one of the most unbusiness-like of men, as he was apparently choked with books and absorbed in abstractions. He quotes an

¹ *Vide* Higgs, *The Physiocrats*, London, 1897, and Seligman, *The Shifting and Incidence of Taxation* (1899), pp. 95-112.

occasion when Adam Smith, in place of signing his own name, imitated the signature of the person who signed before him. If this is true, it is surprising how his remarks on finance contain so much practical wisdom on every page. But one would have expected a work like *The Wealth of Nations* rather from Ricardo, who made a large fortune in business. Ricardo arrives at his conclusions on the incidence of taxation by delicate reasoning, while Adam Smith arrives at his without abstraction and by homely illustration. The importance of *The Wealth of Nations*, even in Adam Smith's lifetime—and he lived for fourteen years after its publication—may be gauged by the fact that there were five English editions during the lifetime of the author, *i.e.* in 1776, 1778, 1784, 1786, and 1789.¹

5. The great effect of the teaching of Adam Smith on the science of public finance was not uniform in all countries. In Great Britain in the first half of the nineteenth century economics was a favourite study to an extent not quite appreciated by subsequent generations. The French Revolution and the Peace of 1815 had a considerable effect on the country. After the defeat of Napoleon trade was bad, employment scarce, and, as recently, there was a considerable interest in the science of business. In Great Britain problems of public finance did not agitate men's minds as they did on the Continent, except perhaps in regard to the question of public debts, where English writers have done considerably more work than those on the Continent. Nothing seems so much to hinder the growth of financial theory as an excellent revenue and budgetary system, combined with general prosperity. Financial or fiscal theory, in other words, flourishes on the defects of economic life. Robert Hamilton (1743–1829), in his *Enquiry concerning the Rise and Progress, the Redemption and Present State, and the Management*

¹ *An Enquiry into the Nature and Causes of the Wealth of Nations*, by Adam Smith, LL.D., F.R.S., formerly Professor of Moral Philosophy in the University of Glasgow (Strahan & Cadell, London, 1776, 2 vols.). The second edition, also in two volumes, was published in 1778. The third edition, in 1784, is in three volumes, and has considerable additions, especially in Book IV., "Drawbacks" and "Bounties". There is a new article in Book V., article 2. The fourth edition, in three volumes, published in 1786, contains no alterations. The fifth and last in the author's lifetime, 1789, in three volumes (Strahan & Cadell), contains no alterations. Besides these there are the "pirated" Dublin editions in 1785 and 1793, in two volumes, based on the fourth and fifth editions.

of the *National Debt of Great Britain and Ireland* (1813), shows, with Aberdonian shrewdness, the fallacy underlying sinking funds. He was the first clearly to prove, although not the first to show, the fallacy of Pitt's sinking fund. He demonstrated that "the excess of revenue above expenditure is the only real sinking fund by which public debt can be discharged", and he illustrated how the then system was useless and harmful, necessitating as it did a high rate of interest and increased cost of management. Four years later, David Ricardo (1772-1823) published his *Principles of Political Economy and Taxation* (1817). Ricardo had the best of preparations for abstract economics. He was a Jew by descent—his father was one by religion—and he spent his life in the most abstract of occupations, namely, that of a stockbroker. He retired with a large fortune from the London Stock Exchange at the early age of 42, and had it not been for his friend James Mill (1773-1836) (whose doctrines were as fire to fuel), he would probably have never written his *Treatise of Taxation*, but merely left us a number of pamphlets of value. The first half of the nineteenth century, it is to be remembered, especially in Great Britain, contains many pamphleteers, but few really comprehensive writers on the science of finance. Ricardo showed how the whole theory and incidence of taxation could be deduced from a few comparatively simple axioms and definitions. J. R. McCulloch (1789-1864), another friend of Ricardo's, said of his work what is now universally regarded as true, that "the brevity with which Mr. Ricardo has stated some of his most important principles, their intimate dependence on each other, the fewness of his illustrations, and the mathematical cast he has given to his reasonings, render it sometimes not a little difficult for readers, unaccustomed to such investigations, readily to follow him. But those who give to his works the attention of which they are so worthy will find that he is remarkably consistent in the use of terms, and that he is as logical and conclusive as he is profound and original". A recent writer refers to his disinterested attitude in regard to his inquiries.¹ Lord Congleton, better known as Sir Henry Parnell

¹ Ricardo's *Economic Essays* (Gonner, G. Bell & Sons, London, 1923). Professor Gonner says: "The trend of economic thought and the new importance attached to economic inquiry make more valuable than ever the study of a writer whose attitude was so disinterested and who, despite his shortcomings,

(1776–1842), in his pamphlet *Financial Reform*, published in 1830, contends that public expenditure is overgrown, and that, especially in the non-productive services, considerable reduction could be effected. He is almost an extremist of the Victorian or Gladstonian school of finance. In 1845 appeared McCulloch's *Treatise on Taxation*.¹ The unattractiveness of McCulloch's writing, indeed his habitual deadness of style, resulted in his work having less influence than it deserved. While, however, he had not perhaps the tenacious grasp of abstract principle or the Euclidean precision of Ricardo, he brings together theory and practice in a way that is seldom realised. This is due to a combination of circumstances. He was editor of the *Scotsman* in 1818–19, Professor of Political Economy in London University, and from 1828 Comptroller of Her Majesty's Stationery Office in London. Seligman, in reviewing this period, remarks on the divorce between theory and practice. "The practical writers did not concern themselves with theory, and the economists were, for the most part, content to work in what might be called a fiscal vacuum. McCulloch was the one important writer to form an exception, and he was not sufficiently successful to find either admirers or successors." Two years after the publication of this book appeared the *Principles of Political Economy*, by John Stuart Mill (1806–1873), the eldest son of James Mill. Mill's teaching on taxation in the fifth book of the *Principles* is pursued with great vigour. He takes up the hardest parts of the subject and discusses them with consistent power—it might almost be said, with enjoyment. In looking back on the development of modern financial theory in Great Britain up to 1850, we are struck by the number of writers who were Scotch, notably precursors of Adam Smith like Hume and Steuart, Adam Smith himself, and successors like Hamilton, McCulloch, and the Mills, father and son. Reading their works is often like living on high ground. They brace the mind just as fine material air does the body. They never skate over difficulties with unconvincing lightness and agility, but grasp the

sought in all he wrote, on the one hand to elucidate facts by reference to principles, and on the other hand to build up out of the data at his command a system of coherent thought".

¹ *A Treatise on the Principles and Practical Influence of Taxation and the Funding System*, McCulloch (London, 1845: Longman, Brown, Green, & Longmans). This edition is scarce.

nettle of financial principles. The cause of this is difficult to explain. Was it the training in metaphysics which the Scotch universities had carefully taught since the Reformation, or was it something more—the particularly practical aptitude of mind which that country has produced? Many of these writers had a special forte in throwing light on the most difficult portions of the subject and of basing theory on practice in everyday affairs.

During the second half of the nineteenth century much, if not most, of the best work in financial theory in English has been done by American writers. There have indeed been one or two notable exceptions. There is, on the purely historical side, Dowell's *History of Taxation and Taxes in England*, in four volumes.¹ There are similar works on local taxation in the United Kingdom. Professor Bastable's *Public Finance*² (1892) is the first book of its kind published in England since the time of McCulloch. The subject is treated with adequate fullness and admirable impartiality, except, perhaps, in the meaning of terms, where the influence of German writers is clearly seen.³ It forms a distinct landmark in English treatises on the science of public finance. Professor Nicholson, in the fifth book of his *Principles*, has surveyed a large part of the field, but without much originality. American writers, such as Professors H. C. Adams and E. R. A. Seligman, deserve a high place in the financial literature of the period. Adams's *Science of Finance—an Investigation of Public Expenditure and Public Revenues* (1898) is a comprehensive work of great value, although somewhat unsatisfactory in the branch of financial administration. It is a standard American treatise on the science of public finance. For Seligman's work (some of which belongs to the beginning of the twentieth century) there can be nothing but praise, and in years to come his work will be seen to have been of outstanding merit. His *Shifting and Incidence of Taxation*, *Progressive Taxation in Theory and Practice*, *Essays in Taxation*, and *The Income Tax*

¹ *A History of Taxation and Taxes in England from the Earliest Times to the Present Day*, by Stephen Dowell, Assistant Solicitor of Inland Revenue (London, 1884: Longmans, Green & Co.).

² *Public Finance*, by C. F. Bastable (London: Macmillan), 3rd edition, 1903, reprinted 1917.

³ An interesting criticism of this work will be found on p. 392 of Seligman's *Essays in Taxation* (Macmillan, 1915).

are well known. No writer on taxation problems in this period has given himself to the subject more whole-heartedly or successfully, or with greater knowledge of his subject than Seligman. Other American works worthy of honourable mention are Plehn's *Introduction to Public Finance* and the chapters on taxation in Taussig's *Principles of Economics*. Since the Great War considerable attention has been given to taxation and taxable capacity. In Great Britain Sir Josiah Stamp's writings, such as *The Fundamental Principles of Taxation, Wealth and Taxable Capacity*, not to mention his *British Incomes and Property—the Application of Official Statistics to Economic Problems*, have given greater emphasis to portions of the subject matter which had, especially before the War, been unduly neglected. Many able Government publications have appeared since the Armistice in English, notably the Report of the Royal Commission on the English Income Tax, 1920; the Report of the Select Committee on the Increase of War Wealth, 1920; the Report on Public Finance of the International Financial Conference (Brussels), 1920; the Report of the Royal Commission in Australia, 1921 (5 vols.); and the Report on Double Taxation by Professors Bruins, Einaudi, Seligman, and Sir Josiah Stamp, for the League of Nations, 1923.¹ Much of this work is fine, massive, and comprehensive, and principles are being evolved afresh as a result of the experience of the War, which must guide the financial ship of State from the uncharted ocean of extravagance into the smoother seas of economy.

6. The volume of financial literature in German belonging to the nineteenth and twentieth century is large, probably on account of the fact that the financial system in Germany, as in France, was more complicated and less satisfactory than in Great Britain. Especially in the latter half of the nineteenth century, there are certain dominating characteristics of this literature, and these are: (1) the historical nature of the work done; (2) the advocacy of social aims in taxation; and (3) the

¹ Seligman, in his *Essays in Taxation*, gives an exhaustive bibliography of official reports in the United States. Among the more modern of them may be mentioned the Report of the Special Taxation Commission of the City of Cleveland, 1915; the Report of the Committee of Taxation of the City of New York, 1915; the Report of Special Commission on Taxation, Boston, 1916; the Report of the Special Tax Commission, New Haven, 1917; and the Report of the Joint Special Committee on Taxation, Boston, 1919.

erudite thoroughness of much of the work. The work of Roscher is an example of the first, and of Wagner, Cohn, and Eheberg on Finanzwissenschaft of the second. The financial system is regarded as an agency for the better distribution of wealth. A good example of the third characteristic is the work of Rau or Nebenius on public credit. Nebenius (1784–1857) belonged to the school of Adam Smith, and in 1820 (2nd edition, 1829) published *Der öffentliche Kredit*, which Roscher somewhat exaggeratingly says is “perhaps the best monograph in the whole economic literature of Germany, and certainly the most important treatise on the subject of public debts which has been written in any language”. Rau (1792–1870), also a follower of Adam Smith, published a treatise on Economics (*Lehrbuch der politischen Oekonomie*) (1826–1837), a portion of which is devoted to finance. Rau’s work had much influence in Germany, where he was, it will be remembered, Professor of Political Economy in Heidelberg from 1822 for many years. Hoffmann (1765–1847), Director of the Prussian Bureau of Official Statistics from 1810 to 1844, published in 1840 his well-known *Theory on Taxation* (*Die Lehre von den Steuern*). Von Hock (1808–1869), Director of Customs in Trieste and subsequently in Vienna, wrote in 1862 a book on public taxes and debts (*Oeffentliche Abgaben und Schulden*). Wagner has described this treatise as presenting “in its pregnant conciseness an almost perfect science of finance, and being by far the best on the technique of finance”.¹ Bastable, too, mentions his work as “specially good, as might have been expected from the production of a trained official, in its discussion of administrative points”.² Roscher also praises “its nice distinctions on the incidence and shifting of taxation”.³ Von Stein (1850–1890), Professor of Political Science at Vienna from 1855 to 1888, published in 1860 his *Lehrbuch der Finanzwissenschaft*, which deals mainly with financial organisation. It covers a vast field—the financial systems of various countries in Europe, and it is sometimes impossible to see the wood for the trees when statistical and historical detail is given in such profusion. Roscher (1817–1894), who was for forty-six years professor at Leipzig

¹ *Finanzwissenschaft*, i. 52.

² *Public Finance*, p. 30, 3rd revised edition.

³ *Gesch. der nat. Ök. in Deutschland*, p. 1030.

University, published in 1886 his *System der Finanzwissenschaft*, which is part of his *System of Political Economy*. Before this he had dealt with the history of economic literature, in which so much is to be found.¹ Roscher gives much detailed information in his treatise that is not to be found in Cohn's less comprehensive but more interesting work.² Cohn is the happy mean between Roscher, who is as strong in history as he is weak in theory, and the radical Wagner, who puts forward sometimes startling theory illustrated by statistics. Cohn is readable and at the same time scientific. In Wagner's *Science of Public Finance*³ one sees that Government is regarded as the distributor of wealth and taxation as the means to redress inequalities of wealth. As Seligman well phrases it: "Much as we may dissent from the fundamental points of Wagner's general position, it must be conceded that he has developed his doctrines with consummate keenness and phenomenal learning, and that his *Science of Finance*, even though incomplete, still stands at the head of financial literature for the suggestiveness of its views and the wealth of its contents".⁴ There are many other writers of importance besides Roscher, Wagner, and Cohn, but it will be sufficient merely to mention Umpfenbach⁵ (whose work has the conservatism of French writers), Neumann,⁶ and Vocke.⁷ Another writer whose work will be discussed in connection with the general property tax is Professor Schanz,⁸ whose *Taxation in Switzerland in its Development since the Beginning of the Nineteenth Century* is already well known, and is of special interest.

7. French financial theory from the time of Adam Smith has marked differences from German theory. It is more conservative

¹ E.g. *Geschichte der englischen Volkswirtschaftslehre*, 1851-52; *Adam Smithschen Systems in Deutschland*, 1867; *Geschichte der Nationalökonomik in Deutschland*, 1874.

² *System der Finanzwissenschaft*, Gustav Cohn (Stuttgart: Ferdinand Enke), 1889; translated by Viblen, Chicago, 1895.

³ *Finanzwissenschaft*, Adolph Wagner (Leipzig: Winter'sche Verlagsbuchhandlung), 1889.

⁴ Seligman, *Essays in Taxation*, p. 363 (7th edition).

⁵ *Handbook of the Science of Finance* (Stuttgart: Ferdinand Enke), 1887.

⁶ *Die Steuer*, Neumann (Leipzig: Duncker und Humblot), 1887.

⁷ *Contributions, Imposts, and Taxes (Die Abgaben, Auflagen und die Steuer, vom Standpunkte der Geschichte und der Sittlichkeit)* (Stuttgart: Cotta), 1887; *Elements of the Science of Finance (Die Grundzüge der Finanzwissenschaft)* (Leipzig: Hirschfeld), 1894.

⁸ "Die Steuern der Schweiz," Georg Schanz (Stuttgart: Gotta Nachfolger), 1890; *Soc. d'État*, p. 3.

and individualistic. Jean Baptiste Say (1767–1832), with his brother Louis (1774–1840), his son Horace, and his grandson, Léon Say (1826–1896), had considerable influence. J. B. Say is looked on as one of the fathers of Economics. His *Traité d'économie politique*, 1803, has been translated into many languages, and his *Cours complet d'économie politique pratique* saw the light in 1828–29. His grandson, Léon Say, published in 1884 *Le Socialisme d'État*, the text of which is “State socialism is a German system of philosophy; . . . legitimate in Germany, it is spurious elsewhere”. In 1886 appeared *Les Solutions démocratiques de l'impôt*. This is directed against the proposal to use taxation as a means of social equalisation. M. Léon Say also edited the *Dictionnaire des Finances* (1894), as well as the *Nouveau Dictionnaire d'Économie* (1892), and the work *Les Finances* appeared posthumously. It describes the mechanism of the French Ministry of Finance. Much of the inductive work of French writers on finance is of a high order. Vuitry¹ (1803–1883), Garnier² (1813–1881), De Parieu³ (1815–1893), and Stourm⁴ are instances. Deductive writers, like Cournot (1801–1877), were few and far between, a matter of regret, as deduction is especially useful in, for example, the incidence of taxation. Leroy-Beaulieu's *Traité de la science des finances*, published in 1877, and Jeze's *Science des finances* may, without doubt, be regarded as standard works, possessing as they do the characteristic clearness and freedom of ambiguity to which the French language particularly lends itself.

8. The work of Italian writers on finance at the end of the nineteenth century and the first two decades of the twentieth is of a very high order indeed. Einaudi's *Corso di scienza della finanza* and Graziani's exhaustive work (*Istituzioni di scienza delle finanze*) are probably the best known to modern scholars. Ricca-Salerno's *Scienza della finanze*⁵ also is noteworthy, as it

¹ *Études sur le régime financier de la France avant la Révolution, 1789 (1876–1883)*; *Le Désordre des finances et les excès de la spéculation à la fin du règne de Louis XIV, et du commencement du règne de Louis XV* (1885).

² *Le Traité des finances* (4th edition, 1883; 1st edition, 1858; 2nd edition, 1862): the title of the 3rd edition was altered from the original, *Les Éléments des finances*. Garnier must not be confused with Garnier (1754–1821) the French translator of *The Wealth of Nations*.

³ *Histoire des impôts généraux* (1856) and *Le Traité des impôts* (1862–64).

⁴ *Le Budget*, Paris, 1913; (translation), New York, 1917.

⁵ Florence (Barbera), 1888.

deals with principles ; his *Theory of Public Debts* and his *History of Fiscal Doctrines in Italy* ;¹ Mazzola's *Scientific Data of Public Finance*, Viti de Marco's *Theoretical Character of Financial Economy* ;² Zorli's *Fiscal Systems*,³ and *Science of Taxation* ;⁴ Conigliani's *General Theory of the Effects of Taxation* ;⁵ Rignano's *Una Riforma socialista del diritto successorio*, and *La Riforma delle leggi sui tributi locali* ; and Pareto's work on Income Tax, are sufficient to show the vast amount of financial literature of merit which places Italy on a very high level, especially in the literature of taxation.

9. In the study of financial literature a discriminating judgment is most essential. Ruskin says books are divisible into two classes, the books of the hour and the books of all time. This is especially so of modern financial literature. There is much, especially pamphlets, that appear at first sight to be of value but are in reality ephemeral. Language difficulties have sometimes made a detailed survey impossible. This applies notably to Holland, although the translations of some works, such as Pierson, are available to English readers. Pierson, for example, was in turn a Professor of Economics, President of the Netherlands Bank, Finance Minister, and Prime Minister of Holland, and combined to an unusual degree a sound knowledge of English, American, and Continental theory with practice in the most literal sense of the term. His work is full of good things.⁶ We have already referred to the importance of reasoning on observed facts, and to the importance of "laying his mind alongside of yours, sir", as Dr. Johnson put it. We must also remember in the study of post-War finance the words of Marshall, when he says that "there is a strong temptation to overstate the economic evils of our own age, and to ignore the existence of similar and worse evils in earlier ages ; for by so doing we may, for the time being, stimulate others as well as ourselves to a more intense resolve that the present evils shall no longer be allowed to exist. But it is not less wrong, and generally it is much more foolish to palter with truth for a good cause than for a selfish cause. And the pessimists' descriptions of our own

¹ Rome (Loescher), 1890.

² Rome (Pasqualucci), 1888.

³ Bologna, 1885.

⁴ Bologna, 1890.

⁵ Milan, 1890.

⁶ *Principles*, Pierson, translated by Wotzel (Macmillan & Co.). His views on the faculty theory of taxation and on progressive taxation will be seen in this translation.

age, combined with romantic exaggeration of the happiness of past ages, must tend to the setting aside of the methods of progress, the work of which, if slow, is yet solid ; and to the hasty adoption of others of greater promise, but which resemble the patent medicines of a charlatan, and while quickly effecting good, sow the seeds of widespread and lasting decay." Constant carping is a most unwholesome occupation.

BOOK II
PUBLIC EXPENDITURE

CHAPTER III

THE CHARACTERISTICS OF PUBLIC EXPENDITURE

1. DURING the greater part of the nineteenth century comparatively slight attention was paid, especially by English, American, and French writers, to public expenditure. The general features of this important branch of the science of finance were not analysed and considered as their importance deserved. There was no sound classification of the expenditure of Central or Federal Governments, Provincial or State Governments, or of purely local authorities, and no canons were laid down as to the principles on which all such expenditure should be based. In the present century the complexion of events has changed all this, and there is no part of the subject which has received so much consideration at the hands of practical financiers and writers on the subject. In the present chapter we shall discuss the main characteristics of public expenditure. The classification and main heads of expenditure will be dealt with in Chapter V., and in Chapter IV. the canons of financial propriety in regard to expenditure will be analysed.

THE IMPORTANCE OF EXPENDITURE

2. A theory of public expenditure in the nineteenth century was not very necessary because the scope of the functions of Government was restricted. Orthodox Victorian finance is the best example of this.¹ It was not confined to England and

¹ "I think the national expenditure ought to increase in proportion to the spread of wealth. Why don't you let the country live like a gentleman?" asked Sir William Harcourt. "Because," said Mr. Gladstone, "living like a gentleman means paying five times its value for everything you buy" (*The Life of Sir William Harcourt*, by A. G. Gardiner, vol. i. p. 388).

other parts of the British Empire, such as India, whose finance ministers have frequently been recruited from the pick of English financiers. It was also a characteristic of continental Europe. In the twentieth century the development of the functions of the State in social matters, *e.g.* in education and public health, and in commercial and industrial undertakings, such as railways, irrigation and similar projects increased in a large degree public expenditure. English finance was profoundly influenced by the social reform which produced old age pensions. In addition to the steady march of democracy and from 1896 the upward trend of prices there were other causes, the chief of which was the preparation for and cost of the Great War. In the six financial years from 31st March 1914 to 31st March 1920, Government expenditure in the United Kingdom exceeded the total expenditure for the two and a quarter centuries preceding 1914, the year in which the outbreak of War took place.¹ The British national expenditure averaged £1,500,000 a day in 1914-15; £3,750,000 in 1915-16; £6,587,000 in 1916-17; and £6,986,000 in 1917-18. The British Parliament sanctioned between 6th August 1914 and 25th November 1918 votes of credit to the extent of £8742 millions, and the War cost Great Britain over £10,000 millions, while, if allowance were made for the expenditure of the Dominions, the total would be well over this amount. In France, expenditure was ten times greater than in the pre-War year; in Great Britain over six times; in the United States five times; in Japan over twice, and in India less than twice the pre-War level. During the five years 1918-19 to 1922-23 the deficits in India's Budgets have amounted to Rs.113 crores,² necessitating an annual charge of nearly Rs.7 crores, and we have to go back to the five years 1857-58 to 1861-62 when such continuous deficits occurred. The total deficits, however, in these years (1857-58 to 1861-62) amounted to only Rs.42 crores. In short, the twentieth century has witnessed public expenditure to a degree which even some years ago would have been regarded as symptomatic of financial madness and a certain collapse of world credit.

¹ *English Public Finance from the Revolution of 1688*, Harvey E. Fisk (New York, 1920: Bankers' Trust Company).

² 1 crore of rupees = 10 million rupees = £666,666.66.

ECONOMY AND RETRENCHMENT

3. In many countries committees were appointed to examine the ways and means by which economy and retrenchment in public expenditure could be effected. Two of the best known reports of such committees are those of the Committee on National Expenditure in Great Britain, usually known as the Geddes Committee,¹ and the Indian Retrenchment Committee, presided over by Lord Inchcape.² The terms of reference to the former Committee were: "To make recommendations to the Chancellor of the Exchequer for effecting forthwith all possible reductions in the National Expenditure on Supply Services, having regard especially to the present and prospective position of the Revenue. In so far as questions of policy are involved in the expenditure under discussion, these will remain for the exclusive consideration of the Cabinet; but it will be open to the Committee to review the expenditure and to indicate the economies which might be effected if particular policies were either adopted, abandoned, or modified." The terms of reference to the Inchcape Committee, modelled on those of the Geddes Committee, were: "To make recommendations to the Government of India for effecting forthwith all possible reductions in the expenditure of the Central Government, having regard especially to the present financial position and outlook. In so far as questions of policy are involved in the expenditure under discussion, these will be left for the exclusive consideration of the Government; but it will be open to the Committee to review the expenditure and to indicate the economies which might be effected if particular policies were either adopted, abandoned, or modified." These Committees explored with unusual care the field of public expenditure, and a study of the Reports brings out clearly some of the important characteristics of this branch of our subject.

It is advisable to distinguish what is meant by the terms

¹ *First Interim Report of Committee on National Expenditure*, Cmd. 1581-1922 (London, H.M. Stationery Office). *Second Interim Report of Committee on National Expenditure*, Cmd. 1582-1922 (London, H.M. Stationery Office). *Third Report of Committee on National Expenditure*, Cmd. 1589-1922 (London, H.M. Stationery Office).

² *Report of the Indian Retrenchment Committee, 1922-23* (Delhi Superintendent Government Printing, India, 1923).

—economy and retrenchment. Economy does not mean merely the saving of money, but rather the spending of money wisely in order that the greatest possible benefit may be derived from the spending of public funds. Economy means expenditure without waste and to the best advantage. Contrasted with economy is parsimony, which implies improper saving of expenditure. Parsimony is sometimes said to be the best tax—"magnum vectigal est parsimonia". Retrenchment goes very much farther than economy and means the lopping off or removal of what is superfluous. There does come a time when sooner or later the expenditure on existing objects requires scrutiny, and the expenditure on these, if already reduced to the minimum, may have to be considered with a view to whether it is justifiable to continue to incur expenditure on these objects. It may then be necessary to draw in one's horns and to reduce the number of objects on which expenditure is incurred. Instances of economy in the Geddes Report may be seen in the recommendations relating to statistics and prison labour. "We have made inquiries as to the extent to which machines are used in the compilation of statistics. We understand that hitherto practically no machines have been used, but that tests are now being made, and we recommend that the use of machines in connection with the heavy statistical work in this office (*i.e.* Customs and Excise Statistical Office) should be persevered with, as when introduced elsewhere material economies have resulted."¹ "We are struck by the fact that this (prison) labour is not more remunerative. We are informed that the present lack of machinery is a great hindrance, and that, in view of the expense involved in having the work supervised by warders at their present rates of pay, the produce does little more than pay the cost of supervision. Further, it is found that in present circumstances Government departments, who are normally the largest purchasers of the products of prison labour, are now able to obtain the same articles at less cost from surplus stocks of War stores. We think that, although on that account it is more difficult at present economically to use prison labour, the use of it upon all Government requirements should be most carefully considered."² The Inchcape Report similarly gives striking examples where economy is possible, notably in the avoidance

¹ *Third Report* (Cmd. 1589), p. 31.

² *Second Report* (Cmd. 1582), p. 81.

of unnecessary movements of troops,¹ the improvement of accounts and statistics on railways,² the method of granting house-rent allowances to general service telegraphists,³ and the disadvantages of allowing one firm to obtain a monopoly in contracts for Government printing.⁴ The Committee give two other examples which will result in economy, viz. the stopping of the rush of expenditure at the end of the financial year in order to avoid the lapse of unspent funds,⁵ and to the lock-up of capital in stores⁶ which the country cannot afford, apart from the consequent expenditure on establishments engaged on the maintenance of stores, the buildings for their accommodation, and the inevitable loss from depreciation. Examples of retrenchment may be illustrated from the Geddes and Inchcape Reports where the cutting down of staff is recommended. The Geddes Committee proposes to do away with staff in the Post Office by reviewing the question of fluidity of staff between various centres to cope with seasonal or special work.⁷ Similarly, the Inchcape Committee recommended the retrenchment of staff on railways, as the retention of a large surplus staff inevitably lowers efficiency.⁸ Retrenchment in regard to Government Publicity Departments was advocated in the House of Commons on 31st July 1923. In some countries and in certain circumstances these may be necessary. A writer in the *Times* of 30th July 1923 wrote: "I do know something about the Civil Service and the new Publicity Departments. The latter are an innovation fraught with sinister and insidious danger alike to public opinion, the independence of the Press, and the credit of Parliamentary life, for they offer endless opportunities for illicit influence, jobbery, log-rolling, underhand propaganda, and the misdirection and 'doping' of the public mind. We have been told hundreds of times how under Bismarck German political life was demoralised by the Government's intimate relations with the Press, and these Publicity Departments, if allowed to continue, will inevitably have the same effect in this country." The Government member representing the Treasury pointed out that there was no

¹ *Report*, p. 17.² *Ibid.* p. 70.³ *Ibid.* p. 99.⁴ *Ibid.* p. 256.⁵ *Ibid.* p. 248.⁶ *Ibid.* p. 292. On 31st March 1922 the value of the stores was nearly Rs. 59 crores (£39,333,333-33), of which Rs. 35 crores were railway stores and Rs. 21 crores army stores.⁷ *Third Report* (Cmd. 1589), p. 42.⁸ *Report*, p. 70.

real necessity for these particular officers, and that any information which it was desirable to publish had much better be given through the instrumentality of a Minister's own private secretary, who would be directly responsible for the information so given.¹

4. It goes without saying that the actual normal expenditure in any year is to a great extent determined by historical conditions or by previous legislation. This is almost axiomatic and is illustrated in Table IV., Appendix, where the main heads of expenditure in India are set out in the form of percentages. The proportional amount spent on the various heads varies from country to country, from province to province, and from local authority to local authority. The expenditure must always be viewed as a whole. Conflicting claims must be carefully weighed. When Gladstone said that "good finance consists more in the spending than in the collecting of revenue", he emphasised the importance of this principle. At the same time, it is to be remembered that Gladstone lived in a period when expenditure on social and Government undertakings had not the importance in public expenditure which they now possess. There is always present the temptation for public authorities to ask for more money than is in reality required, or for services which may be performed more cheaply or dispensed with entirely. This does not in any sense imply dishonesty, but rather the inevitable tendency to over-expenditure on the part of public authorities or their officials. When the policy of Government (*i.e.* what Government does) and the administration (which carries out that policy) are not at fault, then Government expenditure is above criticism. Lavish expenditure is frequently the result of carelessness or weakness on the part of public officials, and it should be the aim of a well-organised financial administration to take measures to prevent the injudicious expenditure of public funds either by the punishment or the exposure of the responsible official or officials. Such expenditure is in most countries checked by a superior authority in the official hierarchy. One department or office subordinate to another department should have its proposals scrutinised by the controlling department, and even by the Finance Department or Treasury, according to the importance of the expenditure proposed. Before the expenditure is placed before the Legisla-

¹ Hansard, 31/7/1923.

ture for sanction it is not unusual for a Committee of the House to sit as a Finance Committee to consider and advise Government on proposals for expenditure which the Government proposes to place before the Legislature. In many countries a further check is exercised by a Public Accounts Committee of the Legislature which follows up any question of audit to which attention has been drawn in order to avoid any improper expenditure of money already sanctioned. It is customary to restrict such committees from questioning matters of policy which do not arise out of the accounts. In Great Britain any expenditure, say by the War Office, would be carefully examined departmentally and by the financial authorities in the War Office. If it required, on account of its importance, the sanction of His Majesty's Treasury before being placed in the Budget this would be done, and then Parliament would be asked to sanction the estimates. The Comptroller and Auditor-General would see that the money was correctly spent in accordance with the purpose for which it was voted and that it was not exceeded. His report would then go before the Accounts Committee of Parliament, who vigilantly watch for any irregular expenditure. All expenditure is met out of the Consolidated Fund or the amount standing to the credit of Government in the Exchequer account. Taxation is imposed not to meet the wants of any special service, but on a survey of the whole financial position. The payments from the Consolidated Fund are made with Parliamentary sanction either annually or once for all. The Supply Services, *e.g.* expenditure on the Army, Air Force, Navy, Civil Services, Customs, Excise, Inland Revenue, and Post Office Services, are voted annually. The Consolidated Fund Services, mainly National Debt Services, payments to Local Taxation Accounts, Civil List, certain salaries and pensions of persons whose independence is held to be better secured by withdrawing these from the annual discussions in Parliament are voted once for all and not annually by Act of Parliament, although such payments are in theory liable to revision by Parliament when it so desires.

PUBLIC AND PRIVATE EXPENDITURE COMPARED

5. It will already be evident that there are differences between public and private expenditure. It is sometimes said that

private expenditure is determined by income, while public expenditure determines the amount of the income necessary to meet this expenditure. This is in the long run true. In the case of the private individual, however, there is a minimum expenditure below which he cannot go, and increased expenditure is essential for increased production of the worker, and therefore increased income.¹ The income of public authorities is not so elastic as is sometimes supposed. The relation of State income, for example, to gross income of the nation has to be considered in arriving at a basis of public expenditure.

Another characteristic of public expenditure is its compulsory character. For nearly a century, certainly from the date of Austin's *Province of Jurisprudence Determined* (1832), it has been well known that a State has a claim on all the property and services of its subjects for whatever purposes it chooses. From the strictly legal point of view this is undoubtedly true, although from the administrative point of view it would not be policy to attempt this. If a Government or State did succeed in taking all the property of its subjects in order to protect the property of the State and its subjects, it would not be worth while to accumulate property. The Government, therefore, is careful not to overtax, but to tax in such a way that taxation is equitable and well distributed. If it is resented it will tend beyond a certain point to be evaded. Thus there is a limit to the action of public authorities, but this does not affect the compulsory nature of public expenditure, a distinguishing feature as compared with private expenditure.

6. Public expenditure differs from private expenditure in that the former should balance income and should not necessarily seek a profit in the manner that an individual would. Since 1845 Indian Budgets with two exceptions, the two quinquennia ending 1862 and 1923, have more or less balanced in spite of famine. The total deficits excluding these two exceptional periods, amounted to Rs.66 crores and the surpluses to Rs.111 crores, the difference being only Rs.45 crores or one-fifth of the total expenditure in 1922-23. More will be said as to this in the discussion of the canon of surplus in Chapter IV.

Another noticeable difference between private and public

¹ Marshall's *Principles*, Book I. p. 137. Compare *Report on an Enquiry into Working Class Budgets*, Findlay Shirras, Bombay Government Press, p. 14.

expenditure arises from the fact that special interests may be powerful enough to oppose successfully those of the State as a whole, with the result that expenditure may be increased unnecessarily. This is sometimes, but in a small degree, the case in private companies. The individual usually spends on what he considers to be for his advantage. In the case of the State this may not succeed because of the existence of sentiment or special interests. This applies with special emphasis to defence, and also to higher and university education. In proposing naval "cuts", after taking into consideration the results of the Washington Conference, the Geddes Committee said that "a civilian might indeed shrink from suggesting any reduction in naval expenditure. We are, however, definitely of the opinion, after our investigation, that this grave advice cannot be justified. In our judgement, this is a forcible illustration of the financial danger of accepting unchallenged the dicta of naval and military experts. Their natural tendency is invariably to be satisfied with nothing short of perfection, to which must be added their inherent desire to maintain the prestige of the Service."¹ The tendency to this in young democracies or where communal feelings and sentiments are strong (as in India, owing to diversity of race, caste, and creed) is especially great.

7. There is a further difference between the expenditure of private individuals and that of public authorities. Ordinarily net advantage governs the expenditure of the citizen who takes up an occupation or occupations which, all things considered, appear most advantageous or remunerative. The State on the other hand is unable to take this as the basis of its expenditure. Similarly with municipalities or local boards. The State, for example, undertakes expenditure on defence, on law and order ; on social objects such as education, poor relief, and public health ; on undertakings of a quasi-commercial nature such as railways, roads, waterways (canals, barrages, and similar irrigation works), posts, telegraphs, and telephones ; it subsidises commercial aerial communications and, among other things, assists agricultural and industrial research. This raises the important question as to the extent to which States should undertake such activities.

8. It is possible to divide the main schools of thought in

regard to the scope of public expenditure into two classes. One school restricts the functions of Government mainly, if not entirely, to the primary functions of defence, law and order, public debt, and the necessities of civil administration. The other school is more generally in favour of an increase in State agency. In fact, it believes in the oft-quoted remark that "nowadays we are all socialists". Adam Smith, in *The Wealth of Nations*, tells us that "every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of any other man, or order of men. The sovereign is completely discharged from a duty, in the attempting to perform which he must always be exposed to innumerable delusions, and for the proper performance of which no human wisdom or knowledge could ever be sufficient; the duty of superintending the industry of private people, and of directing it towards the employments most suitable to the interest of the society. According to the system of natural liberty, the sovereign has only three duties to attend to; three duties of great importance, indeed, but plain and intelligible to common understandings: First, the duty of protecting the society from the violence and invasion of other independent societies; secondly, the duty of protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it, or the duty of establishing an exact administration of justice; and, thirdly, the duty of erecting and maintaining certain public works and certain public institutions, which it can never be for the interest of any individual, or small number of individuals, to erect and maintain, because the profit could never repay the expense to any individual or small number of individuals, though it may frequently do much more than repay it to a great society."¹ Adam Smith severely criticised the East India Company for trying to combine private and public functions, viz. trading and governing, which he believed to be altogether incompatible. Writing nearly 150 years ago he said that "it is a very singular Government in which every member of the administration wishes to get out of the country, and consequently to have done with the Government, as soon as he can, and to whose interest, the day after he has left it and carried his

¹ *The Wealth of Nations*, Book IV. ch. ix. finis (p. 184 Cannan's edition).

whole fortune with him, it is perfectly indifferent though the whole country was swallowed up by an earthquake".¹

9. The best exponent of the school is Parnell or Congleton who, in his pamphlet *On Financial Reform* (1830), says: "The great error which is commonly committed is taking the utility of an expenditure as a sufficient justification of it; whereas, however useful it may be, if it cannot be shown to be absolutely necessary for securing some public object that could not be had by any other means as economic and as convenient, it is superfluous and ought to be discontinued. . . . Every particle of expense that is incurred beyond what necessity absolutely requires for the preservation of social order and for protection against foreign attack is waste, and an unjust and oppressive imposition upon the public."² It is wrongly implied by holders of this extreme "leave-people-alone" theory that private individuals spend money better than their Government does. This is in no way always so, although Gladstone, a champion of Victorian finance, used to speak of leaving money to fructify in the pockets of the people. Twentieth-century finance shows that the State does spend money to advantage, and private expenditure is often wasteful, especially since the War. Huxley, in his well-known *Essay on Administrative Nihilism*, attacks the position held by Parnell and Herbert Spencer. With trenchant logic he says: "If my next-door neighbour chooses to have his drains in such a state as to create a poisonous atmosphere, which I breathe at the risk of typhus and diphtheria, he restricts my just freedom to live just as much as if he went about with a pistol, threatening my life; if he is to be allowed to let his children go unvaccinated, he might as well be allowed to leave strychnine lozenges about in the way of mine; and if he brings them up untaught and untrained to earn their living, he is doing his best to restrict my freedom, by increasing the burden of taxation for the support of gaols and workhouses, which I have to pay".³

10. German writers go so far as to extend the scope of public expenditure to new social undertakings and to magnify the claims

¹ *The Wealth of Nations*, Book IV. ch. vii. finis (p. 140 Cannan's edition). Adam Smith had in his library William Bolt's *Considerations on India Affairs*, particularly respecting the present state of Bengal and its Dependencies, ed. 1772.

² *On Financial Reform*, Sir Henry Parnell, Bart., M.P., 1830, p. 118.

³ *Critiques and Addresses*, p. 10.

of the State against those of the individual. To-day the popular cry is for State intervention. Government should do everything. The general position, however, is that the State should spend money on defence, law, and order, and also on what will increase the material resources of the country as well as on social services such as education and public health. The Geddes Committee's recommendations bear out this view. "As regards Public Health Services, *e.g.* tuberculosis, maternity, and child welfare, there can be no question as to the merits of the objects to be attained. There has, however, been a very large increase in this form of public expenditure since 1918-19, and, while we do not recommend reductions in this expenditure, we do feel that, having regard to the present financial position, the State's contribution next year, at any rate, should not be above the figure provided for the current year. We hope that, with falling prices and the greatly increased incentive to economy, the authorities responsible for this form of activity will be able still further to increase their beneficial work."¹

11. Social services are of direct benefit to the State as a whole, and public expenditure on these is a sound investment because it lessens the number of the unfit. In other words, public expenditure should be carried up to the point where the advantage to the community of an additional dose of expenditure in any direction is counterbalanced by the disadvantage of a smaller dose of taxation. This is the ideal of public expenditure. A careful system of expenditure should always outweigh the possible check resulting from taxation required to finance it. It should be noticed that public expenditure may cause large changes in the character and volume of production. Considerable diversion of wealth may be directed into channels determined by public policy. Public expenditure, in other words, should increase production. Production may be increased by expenditure on defence, law, and order, as these make for conditions favourable to the increase of production. It may be increased by the way in which public expenditure affects the community's working power and its saving power. Wise expenditure on education and public health may in turn indirectly increase the ability and the desire to save. It is necessary to discount the future as little as possible in public expenditure. The community does

¹ *First Report* (Cmd. 1581), p. 136.

not die like the individual, and it is therefore the duty of financiers and legislators to make generous provision for the future by cautious expenditure, especially when such expenditure is to be met from capital. It is a dangerous policy to ask, "What has posterity done for me that I should do so much for posterity?" We must rather think of the famous line in Tacitus' *Agricola*, "Think of your ancestors and of your posterity".

CHAPTER IV

THE CANONS OF EXPENDITURE

THERE are four canons of financial propriety in regard to public expenditure. These are: I. The Canon of Benefit; II. The Canon of Economy; III. The Canon of Sanction; and IV. The Canon of Surplus.

I. Firstly, with regard to the Canon of Benefit. We shall again refer to the principle of benefit in dealing with the classification of public expenditure.¹ The ideal is maximum social advantage.² Other things being equal, public expenditure should bring with it important social advantages such as increased production, the preservation of the social whole against external attack and internal disorder, and as far as possible a reduction in the inequality of incomes. In short, public funds must be spent in those directions most conducive to the public interest, *i.e.* maximum utility is to be attained in public expenditure. This reminds one of Beccaria's expression³ in the preface to his remarkable little pamphlet *Dei delitti e delle pene* (Crimes and Punishments) (1764)—“the greatest happiness of the greatest number” (*la massima felicità divisa nel maggior numero*), a phrase that has penetrated deep into the mind of every writer on the science of public finance. Maximum social advantage is the aim of the financier in public expenditure.

This canon requires further analysis. It does not mean that because primary public expenditure has to be undertaken before secondary public expenditure that expenditure on primary heads

¹ See Chapter XIII.

² See *Ibid.*

³ Cf. Priestley's *Essay on Government* (1768) and Bentham's *Fragment on Government* (1776). “Priestley was the first (unless it was Beccaria) who taught my lips to pronounce this sacred truth; that the greatest happiness of the greatest number is the foundation of morals and legislation” (Bentham).

must always have precedence over those which are secondary. It may be necessary to stop expenditure on defence after a limit is reached in order to devote more and more expenditure on a social service, such as education. Nor can each claim on public funds be settled regardless of other conflicting claims. Expenditure should be viewed as a whole, and adjudication made on the various competing claims for new expenditure.¹ "The ideal of public expenditure", says Nicholson with great truth, "on the utilitarian principle would be attained when the public utility of the marginal expenditure in each case is equal. The ideal is no doubt unattainable, but it is not unthinkable, and the pursuit of it may lead to important practical results. Without a beacon of this kind expenditure may be continued in certain directions long after it is justified by changing conditions, and the most necessary reforms may be met with the *non possumus* of passive inertia." ²

In regard to the canon of benefit it is a well-recognised rule that no public expenditure should be permitted for the benefit of a particular person or section of the community unless (a) the amount of expenditure involved is small; (b) a claim for the amount could be enforced in a court of law; and (c) the expenditure is in pursuance of a recognised policy or custom. This has been adopted in most countries. In India the principle arose in connection with the polo grounds constructed at Delhi on the occasion of the King-Emperor's Durbar. No objection was raised to the initial expenditure, but the Auditor-General did object to the proposal that Government should maintain the grounds as polo grounds because these grounds would benefit only those who would play polo, and therefore the cost of upkeep should fall on them, not on Government. The third exception above is intended to cover such cases as the grants made on the successful termination of the War to Field-Marshal Haig and Admiral Beatty. It also covers expenditure on behalf of communities that have been recognised as a matter of policy, *e.g.* grants to certain schools and colleges and hospitals. But a grant for the construction of a temple or mosque in India would not be in accordance with the principle laid down as this is not a recognised policy or custom.

¹ Cf. Chapter III.

² Nicholson, *Principles of Political Economy*, vol. iii. p. 379.

II. The Canon of Economy. The canon of economy is a canon that is frequently abused owing to weak financial administration. The same vigilance is required in public expenditure as a person of ordinary prudence exercises over his private expenditure. The price of economy, as of liberty, is eternal vigilance, and there can be no assurance of effective action without the resolute application of the spur of sound financial control and sound public opinion.

Economy, too, means protecting the interests of the taxpayer not merely in effecting economies in expenditure, but in developing revenue. Especially in public works, disbursing and controlling officers must see that the expenditure incurred is necessary and the rates fair. A great deal of intelligence and care on the part of senior officers is required in the scrutiny of rates. Similarly, in stores and workshops, more attention has to be paid to large questions such as are involved in stores than to petty rules on pay and allowances. The British Ministry of Munitions (now defunct), the Office of Works, and the Ministry of Labour are all mentioned in the Report of the British Public Accounts Committee, published as a White Paper in August 1923 for a transaction under which a factory was taken over from the Ministry of Munitions by the Office of Works and handed over to the Labour Ministry, none of them apparently being aware until two years later that the £17,000 worth of stores in the building were not held on ledger charge by any of them.

Some time ago an officer on arrival in Bombay from England was ordered to Maymyo, the hill-station of Burma. Three days after his arrival in Maymyo he was reposted to Bombay. He had his wife with him all the time, and covered some thousands of miles. The 6th Jats Regiment was at Jhansi early in 1919; in September they were moved to Ferozepur, depot and all; and in January 1920 they were moved back to Jhansi, and at the end of that year to Delhi, where also their stay was short. May this not to some extent be due to moves ordered and countermanded, unnecessary transfers especially of officers because of want of forethought? The British Public Accounts Committee, in the report above referred to, cites further similar examples of the absence of economy in public expenditure. The Office of Works is criticised for defective co-ordination between its different branches, as illustrated by the payment of rent for a building at Pontypridd

for eleven years after it had been given up. The Colonial Office is criticised for not informing the Commonwealth Government that a proposed internment camp in Australia was not required, the result being an unnecessary expenditure of £132,000, the greater part of which, however, is recoverable from other Governments. A subsidy to the British Italian Corporation of £283,418 had been paid, as arranged by Government in 1916, and the Committee comment: "The witness who appeared before the Committee was unable to inform them what advantages had accrued to H.M. Government from the payment of this subsidy". The Committee give an apt illustration of the spending of public moneys not on the lines followed by a person in respect of his own money. In 1918 two typewriting machines were hired by the Air Force when there was a shortage of these machines, at a rent of £2 : 10s. a month, which the Committee was informed was not unreasonable for a period of a month or two, but could not be justified for an extended period. In December 1918 the Air Ministry, on learning that the Stationery Office was once more in a position to supply typewriters, gave general directions that all hiring should cease forthwith. The hire of these particular machines was continued in one case for one year, and in another case for two years, and in addition one of the machines was lost. In consequence an unnecessary payment of £120 was made from public funds. In all these examples of public expenditure there was need for pitiless economy. Public authorities, especially at the time of year when they are preparing their several budgets, require all the curb that conscientious heads, political and executive, or a vigilant public opinion can apply. The Treasury (or Finance Departments) must, in a special degree, prove to be an unsleeping guardian of the public purse.

III. The Canon of Sanction. The canon of sanction is that no public expenditure should be incurred without proper authority. A remarkable instance of the breach of this rule is given in a public report of an Accountant-General on the accounts of a certain Provincial Government in India for 1921-22. A Circuit House was, in the opinion of the Provincial Government, urgently required, and the work was commenced in April 1920 "without proper sanction, allotment of funds, call for tenders, or the other usual formalities required by the Public Works Department Code". In June 1920 the plans and estimates amounting

to nearly Rs.1,97,000 were sent to the Central Government for approval, as the proposal exceeded the limit of Rs.30,000, up to which the Provincial Government was competent to sanction expenditure on a new Circuit House. The Government of India considered that the expenditure proposed to be incurred appeared unreasonable for the purpose, and regretted their inability to sanction the scheme. The Circuit House was renamed District Bungalow, "as it was intended for the use of various touring officers and others", and the Local Government went on with the scheme, although the average cost of these bungalows was Rs.9,000. The Government of India refused to sanction the expenditure, but finally, "in view of the fact that the money had already been expended, have since decided not to press the matter further, and have accorded sanction, which they considered useless to withhold in the circumstances, to the action of the Local Government". The Public Accounts Committee of the Legislative Council endorses the Accountant-General's disapproval of the procedure followed, and "they desire to point out that either the Finance Department failed to exercise control or the Administrative Department failed to obtain the statutory approval of the Finance Department. To guard against the latter contingency the Committee consider that any officer taking action, or directing that action should be taken, before the statutory examination and approval of the whole scheme by the Finance Department, should be warned that he may be held personally liable." The net result was that the bungalow was built at a cost more than ten times that of the most expensive district bungalow previously erected in the Province, and at a cost more than twenty times of the average district bungalow. In the (British) Public Accounts Committee's Report, already referred to above, there are cases of similar waste through the breaking of this canon. The Office of Works is criticised for the payment of over £12,000 for additional work on a tender which originally amounted to only £930, and the Air Services are found fault with at some length, in one case for a gift of £10,000 to a Dominion without Treasury authority, in a second case for cancelling an old contract and making a new one on a higher basis also without Treasury authority.

The canon of sanction also includes the following rules : (1) No expenditure should be sanctioned by an authority which at

a later date is likely to involve expenditure beyond its own powers of sanction ; and (2) loans should be spent only on those objects for which money may be so borrowed, arrangements being made for a sinking fund or other form of amortisation for the liquidation of the debts. It would be a breach of the former rule if a public authority made certain temporary appointments as an experimental measure when, as a result of this experiment, there would be a change in system costing more than that public authority had power to sanction. The second rule is intended to prevent money being spent on objects, the expenditure on which is intended to be met from current revenues.

IV. The Canon of Surplus. The canon of surplus is the avoidance of deficits in public expenditure. In arriving at a surplus or deficit the financier should be careful not to debit to capital what should be met from revenue and *vice versa*. Otherwise there will be no true surplus or no true deficit. The Great War has taught the vital importance of this canon and it applies equally to Central or Federal Governments, provincial or State Governments, and to purely local authorities. A moderate surplus in public finance is safe and necessary as is illustrated by the chart showing surplus and deficits in India from 1845, frontispiece. A moderate surplus, something of the nature of till-money in shops, does not produce extravagance. Some writers believe in moderate deficit financing, as it leads to economy. The main fact is, however, the importance in public expenditure of avoiding deficits. Public authorities must earn their living and pay their way like ordinary citizens. Balanced budgets must, as in private expenditure, be the order of the day. Annual expenditure must be balanced without the creation of fresh credits unrepresented by new assets. The International Financial Conference which met at Brussels in 1920 laid it down in most unequivocal terms that "the country which accepts the policy of budget deficits is treading the slippery path which leads to general ruin ; to escape from that path no sacrifice is too great".¹ In Gladstone's words : "It is not from mere extravagance, but it is from disregarding the balance between income and expenditure that those cases of financial confusion have arisen in different countries which have found their upshot in revolution and ruin. So long

¹ Cf. Resolution II. of the Resolutions proposed by the Commission on Public Finance and adopted unanimously by the Conference.

as you keep your income up to your expenditure, and the people pay their way, in a country like this, if they find the burden too heavy, they will take care that you reduce expenditure. Therefore, this is the real test and real safeguard, and the true cornerstone of all sound finance.”¹ Stable finance rests not on pious hopes, but on making both ends meet.

¹ National Liberal Club, London, 2nd May 1883.

CHAPTER V

THE CLASSIFICATION OF PUBLIC EXPENDITURE

1. THE classification of public expenditure presents several interesting problems. For the examination of the theory of public expenditure, a classification is of course obviously necessary. In this and the following chapter we shall, in the first place, attempt to classify public expenditure in such a way as to avoid overlapping and obvious criticism. Secondly, the main heads of expenditure will be reviewed. The test of good public expenditure, as we have already shown, is not in the aggregate expenditure, but in the relative amounts which are assigned to the several heads from time to time. Governments have to invest large sums for the development of their resources. Otherwise delay will occur in reforms and in the attainment of a higher plane of living. An attempt will also be made to answer the question: What is the relation of Central (or Federal), Provincial (or State), and local expenditure to each other? and we shall also consider the advantages, if any, of distinguishing between productive and unproductive expenditure, normal (or ordinary), or abnormal (or extraordinary), and recurring or non-recurring expenditure. Finally, we shall inquire what expenditure should be chargeable to revenue on the one hand, and to capital on the other.

2. Nineteenth-century writers have usually classified public expenditure from the point of view of benefit conferred or from the revenue received in return for services rendered. Others have classified expenditure in accordance with governmental functions—protective, commercial, and developmental. German writers such as Cohn ¹ and American writers such as Plehn ² are

¹ Cohn, 79-91.

² Plehn, *Public Finance*, Part I.

the best examples of those who classify according to the benefit which each class of expenditure confers. Plehn's classification is briefly : (1) Expenditure which confers a common benefit on all, *e.g.* defence. This is the most important class ; (2) expenditure which confers a special benefit on certain people, but which should be treated as a common benefit because of the incapacity of those classes, *e.g.* poor relief ; (3) expenditure which confers a special benefit on certain persons and at the same time a common benefit on the remainder, *e.g.* the administration of justice ; (4) expenditure which confers only a special benefit on individuals, *e.g.* expenditure on State industries. All expenditure may be said to be in the public interest, and the difficulty of assigning the various heads of expenditure to these four categories is obvious.

3. It is difficult to eliminate the element of special advantage even in the case of the first class. Some of us derive larger utility from expenditure on defence or on law and order than others. In fact it seems as if the third class embraced the other three. "As regards benefit alone," writes Nicholson,¹ "all these kinds of public expenditure must be held to confer a common benefit or to satisfy a public want as their essential justification, although they also—all of them—incidentally confer special benefits on individuals or classes or localities. Thus defence is placed in the first class because ostensibly it is for the common benefit only ; but as a matter of history most wars have been undertaken in the defence of particular places or classes or even individuals. Poor relief is ostensibly for the benefit of the particular individuals concerned ; but as a matter of public policy it confers common benefits in the prevention of crime and in the satisfaction of the sense of justice or of charity. Free education manifestly confers special benefits both on the particular children and their particular parents ; but again, the common benefit is so great that by Professor Plehn it is placed in the first class. Finally, as regards class (4), which is said to confer only a special benefit on individuals, it may be said that the final cause of all progress in public expenditure has been the abolition of this class. From being the greatest, it has become the least in importance. Public expenditure which does not confer some common benefit or answer some public purpose

¹ *Principles of Political Economy*, Nicholson, vol. iii. .

ought not to exist in the modern state. This was the position emphatically laid down by Adam Smith, *e.g.* 'The protection of any particular branch of trade is a part of the general protection of trade, a part, therefore, of the duty of the executive power'.¹ And it may truly be said that the greatest financial reform effected since his time has been the substitution of the principle of common benefit for the benefit of particular places or placemen or 'interests'."

4. The second classification referred to above, *i.e.* according to the amount of revenue obtained by the State in return for the services rendered, is that adopted by Nicholson. In many ways it is superior to that of Cohn or Plehn. The classification briefly is: (1) expenditure without direct return of revenue, *e.g.* poor relief; or in some cases even with indirect as well as direct loss, *e.g.* expenditure on war; (2) expenditure without direct return but with indirect benefit to revenue, *e.g.* education. It is usually assumed that educated people are better taxpayers or less expensive to the State than, say, criminals or paupers; (3) expenditure with partial direct return, *e.g.* education for which fees are charged, subsidised railways which pay part of their running expenses; (4) expenditure with full return or even profit, *e.g.* the post office, gas works, and generally State industries. The main criticism of this classification is that it fails to distinguish the main differences in the various classes of public expenditure. It is also, like the former classification, not clearly cut. There may be considerable doubt regarding the particular items to be placed in group (1) and in group (2).

5. Professor Adams, in classifying public expenditure according to the functions of government, has the following main groups and sub-groups: (1) protective functions—(a) military, (b) police and court, (c) social disease (prisons, asylums, pauperism, sanitation, etc.); (2) commercial functions; and (3) developmental functions. These developmental functions include (a) education, (b) public recreation, (c) prosecution of private business, (d) public investigation, *e.g.* the collection of social statistics, and (e) the development of the physical basis of the State, *e.g.* public works, docks, lighthouses, etc. Here, again, the main criticism is the difficulty of placing the several kinds of expenditure under these main heads. Should, for example,

¹ *The Wealth of Nations*, Book V. chapter i. part iii.

expenditure on recreation always be classed as developmental? Expenditure on the collection of statistics may be either commercial or developmental. The foreign trade returns belong to the former, and the collection of social statistics usually to the latter. In other words, commercial expenditure may sometimes be developmental when it makes for future well-being. Where, again, is the line to be drawn between protective and developmental functions? Expenditure on protection promotes progress or development. A classification more in harmony with the everyday expenditure of countries is undoubtedly essential.

6. There are, again, the classifications of Mill into necessary and optional, and of Roscher into necessary, useful, and superfluous or ornamental. By the term optional Mill means that the expediency of Government's exercising those functions does not amount to necessity, and is a subject on which diversity of opinion does or may exist. The terms necessary and optional connote a distinction which few would recognise in these days of the growing sphere of State activity, especially if expenditure on education and public health is classed as optional expenditure.

THE IDEAL CLASSIFICATION

7. The ideal classification is to divide public expenditure into two main classes—primary expenditure and secondary expenditure. Primary expenditure includes all expenditure which Governments, worthy of the name of Governments, are obliged above everything else to undertake, viz. defence, law and order, and the payment of debts. Secondary expenditure includes social expenditure, expenditure on public undertakings, and certain miscellaneous expenditure.

The primary expenditure of Governments embraces four well-known heads of expenditure: (1) defence—naval, military, and air; (2) law and order, which include (a) law and justice, such as the cost of the judiciary, of prisons and convict settlements, and (b) police; (3) civil administration, which covers the salaries and allowances of heads of governments or administrations, the charges of secretariats, the greater part of the Civil Services,¹

¹ In India, for example, certain medical and educational officers (professors and inspectors of schools) are Government servants, but the cost is

together with the expenses of the legislature and certain political charges such as the salaries and expenses of representatives abroad: it must also include the cost of collection of taxes; (4) debt services which cover expenditure, both for ordinary or

CLASSIFICATION OF THE GROSS EXPENDITURE CHARGEABLE AGAINST THE
REVENUE OF INDIA (CENTRAL AND PROVINCIAL)

(Detailed Tables will be found in the Appendix)

Heads of Expenditure.	50 Years ago.	30 Years ago.	20 Years ago.	10 Years ago.	Pre-War Year.	1921-22.
<i>Primary.</i>	1871-72.	1891-92.	1901-02.	1911-12.	1913-14.	
I. Defence	33.4	26.5	28.9	26.5	25.6	32.6
II. Law and Order:						
Law and Justice . .	5.9	4.2	4.9	4.9	5.0	3.3
Police	4.7	4.4	4.5	5.8	5.8	5.3
Total	10.6	8.6	9.4	10.7	10.8	8.6
III. Civil Administration:						
General Administration	3.8	2.0	2.2	3.3	2.4	4.6
Cost of collection . .	10.2	7.8	9.1	7.5	7.9	5.3
Political	0.6	0.9	1.1	1.3	1.4	1.0
Total	14.6	10.7	12.4	12.1	11.7	10.9
IV. Debt Services:						
Productive	3.6	6.6	9.2	9.9	10.4	7.9
Unproductive	12.2	4.8	3.3	2.6	1.8	7.1
Total	15.8	11.4	12.5	12.5	12.2	15.0
Total Primary	74.4	57.2	63.2	61.8	60.3	67.1
<i>Secondary.</i>						
V. Social:						
Education	1.3	1.6	1.2	2.5	3.7	3.8
Other social	1.4	2.6	2.7	2.9	3.1	2.7
Total	2.7	4.2	3.9	5.4	6.8	6.5
VI. Government or Public Undertakings	12.1	31.8	23.1	24.2	25.7	20.8
VII. Miscellaneous	10.8	6.8	9.8	8.6	7.2	5.6
Total Secondary	25.6	42.8	36.8	38.2	39.7	32.9
	100.0	100.0	100.0	100.0	100.0	100.0

unproductive debt, and also for productive debt on the principle that both result in a mortgaging of the country's future revenues, and must be a first charge on expenditure.

Secondary expenditure, on the other hand, includes under

rightly debited under social services, as these officers are not engaged in civil administration.

social expenditure education, public health, poor relief, unemployment insurance, famine relief, and similar social services. Under Government or public undertakings are included concerns of a quasi-commercial or industrial nature, such as railways, irrigation, canals, barrages, roads, and other public works, posts and telegraphs, telephones, subsidies for industrial and agricultural research, geological and other surveys, and grants to develop commercial aerial communications. Under the miscellaneous group are included pension charges, drawbacks, or refunds.

This classification gives on the whole the best results. It is in accordance with the primary and secondary functions of government. All classifications presuppose a knowledge of the subject classified, and an appeal to history or common sense is essential in cases of doubt. The science of public finance postulates a knowledge of political science, especially of the State and its functions. It will be interesting to apply the classification outlined above to India. India has been selected because it has always been regarded as possessing on the whole an efficient and an economical Government which has mainly confined its activities to the primary functions of government. The expenditure includes the expenditure of central and provincial governments, but excludes the expenditure of purely local bodies such as municipalities and district boards.

The salient fact which emerges from these very necessary figures is that primary expenditure is a shade over two-thirds of the total expenditure. Of the remaining third, over 20 per cent is on Government or public undertakings, the expenditure on

GROWTH OF EXPENDITURE ¹

	50 Years ago (1871-72).	20 Years ago (1901-02).	Pre-War Year (1913-14).	1921-22.
Education	100	169	752	1421
Medical and Sanitation . .	100	183	401	945
Police	100	182	329	578
Defence	100	159	196	479
Debt Services	100	145	197	468
Civil Administration . .	100	156	204	366

For detailed table see App. (Table No. VI.).

education being woefully insufficient—not 4 per cent of the total. It is, however, satisfactory to note that the growth of expenditure over the last half century has been greatest in social expenditure under education and public health, followed by that on police.

NET EXPENDITURE ON PRINCIPAL HEADS BY COUNTRIES

8. An attempt has been made to show the net expenditure in different countries in the pre-War and post-War years. The table will be found below. Comparisons have to be made with great care and with many qualifications. The basis is so radically different that direct comparison is often of little value. Different meanings are attached in different countries to the details to be included under, for example, civil administration and the cost of collecting revenue. The expenditure on education is the least comparable of all. In some countries local expenditure is not included in the central Budget. If it were it would raise the expenditure in Great Britain to 15 per cent, while in the Budget it is only 4.3 per cent of the expenditure. The cost of defence, interest on public debts, amortisation, and pensions are items in which there is the greatest uniformity. Some countries show under Government undertakings in the Budget only the *balance* of expenditure, *i.e.* working expenses are excluded, while others include working expenses. Some include as expenditure for a given year actual outgoings in that year, while others, such as France, include expenditure payable in respect of that year, and accounts are accordingly not closed until long after the period to which they relate. Those countries which differentiate between ordinary and extraordinary expenditure do not follow a uniform method. Germany, for example, includes in extraordinary expenditure only outgoings for capital purposes, while others include exceptional items but not investments. Czecho-Slovakia, for example, has a special investment Budget. Other countries, again, include under extraordinary expenditure both capital expenditure and other more or less non-recurring expenditure. Others do not distinguish between ordinary and extraordinary expenditure in their Budgets. A protracted study of these Budgets shows the fundamental differences that exist. At the same time they throw light upon the situation brought about by the Great War.

PERCENTAGE DISTRIBUTION OF NET * EXPENDITURE IN DIFFERENT COUNTRIES (PRE-WAR AND POST-WAR) †

Head of Expenditure.	India.		South Africa.		New Zealand.		United Kingdom.		France.		Italy.		Japan.	
	Pre-War.	Post-War.	Pre-War.	Post-War.	Pre-War.	Post-War.	Pre-War.	Post-War.	Pre-War.	Post-War.	Pre-War.	Post-War.	Pre-War.	Post-War.
Cost of collecting Revenue ‡	9.1	8.3	0.8	0.8	1.1	..§	2.6	0.8	..§	..§	11.5	7.5	1.7	1.2
Defence	21.4	26.8	6.0	3.5	5.4	11.7	44.7	16.8	40.3	11.8	25.6	23.8	35.4	47.9
War and other Pensions	8.1	6.8	2.2	4.8	4.3	8.5	8.0	11.1	7.6	15.8	4.6	5.8	5.8	3.6
Debt Services	12.0	14.0	19.9	16.8	26.1	25.7	14.1	42.4	21.5	22.0	26.4	19.0	26.3	10.0
Education ‡	3.8	4.1	1.1	0.9	11.8	9.6	11.0	4.3	8.2	3.0	5.6	..	2.0	2.7
Civil Administration	25.8	23.4	25.2	28.7	19.8	..§	18.8	6.6	21.6	6.6	19.2	16.9	28.8	34.6
Deficit on Quasi-Commercial Undertakings . . . . .	..	..	14.6	17.4	..	..	..	0.3	..	..	..	1.8	..	..
Others	19.8	16.6	30.2	27.1	31.5	44.5	0.8	17.7	0.8	37.8	7.1	25.2	..	..
Total	100	100	100	100	100	100	100	100	100	100	100	100	100	100

* Net expenditure means total expenditure minus revenue from the particular item, e.g. gross expenditure on railways minus revenue therefrom.

† Pre-War means 1913 or 1913-1914 and post-War 1919 or 1919-1920.

‡ These items are not strictly comparable, as different meanings are attached to cost of collection of revenue, and as education is provincialised in some countries.

§ This is included under Civil Administration or others.

• || Not specified.

CHAPTER VI

EXPENDITURE ON THE PRIMARY FUNCTIONS OF GOVERNMENT

1. THE outstanding feature of modern expenditure is the high figure required for defence. Writing 150 years ago, Montesquieu said that "a new disease has spread through Europe; it has seized on our sovereigns and makes them maintain an inordinate number of troops. It is intensified, and of necessity becomes infectious, for as soon as one state increases its forces the others at once increase theirs, so that nothing is gained by it except general ruin. Each monarch keeps on foot as many armies as if his people were in danger of extermination; and this struggle of all against all is called peace!"¹ This was written nearly thirty years before the publication of *The Wealth of Nations*. Justin, writing two decades after Montesquieu, laments the extravagance that prevails, and states that one-half of the income of European states was utilised in military expenditure, and in cases of states with threatening neighbours even two-thirds. Prussia spent three-fourths. The International Financial Conference of 1920 had the same tale to tell, viz. that rigorous, vigilant, and even meticulous economy as well as retrenchment were necessary. It showed that on an average some 20 per cent of the expenditure of nations was still devoted to the maintenance of armaments and for the preparations of war. The Conference affirmed "with the utmost emphasis that the world cannot afford this expenditure. Only by a frank policy of mutual co-operation can the nations hope to regain their old prosperity; and in order to secure that result the whole resources of each country must be devoted to strictly productive purposes." The Conference, therefore, recommended the desirability of a reduction in the

¹ *L'Esprit des lois*, Book XIII. chapter xvii.

burden of armaments which impoverished countries and imperilled their recovery from the ravages of war. In November 1921 an international conference representing Great Britain, France, America, Japan, and Italy resulted in the scrapping of ships and, in fact, a ten years' "naval holiday". The question of extension of the Washington Conference decision to other naval powers and the feasibility of reducing military and air forces were considered by the Assembly of the League of Nations in 1922. Both of these proposals have at bottom a great financial future.

2. It is of interest to examine the facts, and the following summary table brings out the essential facts. A column has been added to show the rise in wholesale prices, as part of the increased cost of defence is due to changes in the value of money.

EXPENDITURE ON DEFENCE, INCLUDING THE ARMY, THE NAVY, AND THE AIR FORCES IN VARIOUS COUNTRIES AT THE PRESENT TIME WITH PRE-WAR YEAR, TOGETHER WITH WHOLESALE INDEX NUMBERS.

	1913.	1920.	1921.	1922.	Wholesale Prices Index, 1922.
India	100	277	224	212	181
United Kingdom	100	411	290	194	157
Australia	100	180	164	133	165
Canada	100	249	203	179	165
South Africa	100	149	111	95	128
Japan	100	339	399	339	196
France	100	406	377	290	324
Italy	100	..	343	290	581
Belgium	100	1024	700	634	363
Switzerland	100	109	136	146	165
U.S.A.	100	..	573	296	149

It will be seen that at the end of 1922 the cost of defence had in some countries, such as Great Britain, Canada, India, Japan, and Belgium, exceeded the increase in the rise of wholesale prices. Great and useful work has been done by retrenchment committees in many countries. The Geddes Committee on National Expenditure proposed, for example, a reduction of no less than 35,000 officers and men in the British Navy and 50,000 officers and men in the British Army, the reduction in the latter being made without reducing the officers and men employed by the War Office on foreign service.¹ The Committee mentioned,

¹ *First Report* (Cmd. 1581), p. 31.

too, the financial danger of relying exclusively on expert opinion on defence. To this a reference has already been made.¹ The Committee referred to the high salaries of the Fighting Services, and pointed out that these had a greater proportion of highly paid posts than the Civil Services. In order to stimulate ambition and to secure the necessary reward for ability and hard work, those occupying the higher posts deserve to be well remunerated, but not to an excessive degree.² Most people, too, will agree that Adam Smith was quite right when he said that to be a good soldier a man must devote his whole time to the business, and a country cannot depend only on militias. This means expenditure. Governments and legislatures recognise that an efficient system of defence repays itself by the security it affords for trade and prosperity. They recognise, too, that in ordinary times people become so used to what such a system brings that they never realise what it means—just as in the case of air and water—until there is an insufficiency. In India we have become so accustomed to the advantages of peace and good government that it is difficult for the ordinary man in the fields or in our streets to realise their true worth. Japan, with a population of about one-sixth that of India, spends on her naval and military forces nearly twice as much as India does. India's sea-borne trade amounts to Rs.600 crores, and yet her annual contribution for naval defence is not more than Rs.15 lakhs. Nevertheless, with a broken and exhausted Europe, retrenchment and economy are essential. "In our opinion", wrote the Geddes Committee, "full economy in the Fighting Services cannot be realised under existing conditions. There is overlapping and duplication throughout. In order to fully realise these economies the three forces must be brought together by the creation of a co-ordinating authority or a Ministry of Defence responsible for seeing that each force plays its part and is allotted appropriate responsibility for carrying out various functions. The theory of such a Ministry in embryo appears already to exist in the Committee of Imperial Defence. With the creation of a co-ordinating authority or Ministry of this description it would be possible to ensure that corresponding reductions in expenditure were realised when either of the older Services was relieved or assisted, and no

¹ *Third Report* (Cmd. 1589), p. 166.

² Cmd. 1589, p. 156.

additional expense or extra-ministerial appointment need, in our opinion, be involved, as the Minister and his staff could be drawn from existing organisations. All the arguments of an economic character which have been urged for the absorption of the Air Force into the two older Services apply, in our opinion, also to the fusion of all three Services under one Minister. Complete co-ordination in supply, transport, education, medical and other services would then be possible.”¹ Similarly, the Inchcape Committee on Indian Expenditure recommended that “a close watch be kept on the details of military expenditure with the object of bringing about a progressive reduction in the future. Should a further fall in prices take place, we consider that it may be possible, after a few years, to reduce the military budget to a sum not exceeding Rs.50 crores, although the Commander-in-Chief does not subscribe to this opinion. Even this is more, in our opinion, than the taxpayer in India should be called upon to pay, and, though revenue may increase through a revival of trade, there would, we think, still be no justification for not keeping a strict eye on military expenditure with a view to its further reduction.”² The expenditure on defence in India in 1921-22 was 32.6 per cent as against 25.6 per cent in the pre-War year of the total gross expenditure (central and provincial).³ There are not a few who are reminded, in these days of high expenditures on defence in the chief countries of the world, of Hogarth’s picture of the old steward in the “Rake’s Progress” holding up his hands in horror and despair at the extravagance of his old master.

LAW AND ORDER

3. Law and order is a primary and indeed an all-important function of the State, but, for obvious reasons, it costs less than defence. The imagination of the plain man in the street is left gasping when he is told that the latest capital ship in the British Navy, completed in 1920, notwithstanding it is twice the size of the largest battleship in the Great War, is “now obsolescent”. He realises how money has to be poured out on defence at times, and he sees that the preservation of law and order is compara-

¹ *First Report* (Cmd. 1581), p. 8.

² *Report*, p. 58.

³ See detailed table, V. App.

tively cheap as compared with defence. In India in 1921-22 it was 8.6 per cent of the total expenditure as against 32.6 per cent for defence. Adam Smith did not notice the importance of police in his discussion of law and order, or, as he calls it, "the expense of justice".¹ He reminds us that where there is little or no property there is no need of a civil magistrate. "But avarice and ambition in the rich, in the poor the hatred of labour and the love of present ease and enjoyment, are the passions which prompt to invade property, passions much more steady in their operation and much more universal in their influence. Wherever there is great property there is great inequality. For one very rich man, there must be at least five hundred poor, and the affluence of the few supposes the indigence of the many. The affluence of the rich excites the indignation of the poor, who are often both driven by want and prompted by envy to invade his possessions. It is only under the shelter of the civil magistrate that the owners of that valuable property, which is acquired by the labour of many years, or perhaps of many successive generations, can sleep a single night in security."² We are not concerned with tracing the development of law and justice and also police. It is important, however, to note that sufficiently attractive salaries and wages and indeed fairly good housing or the equivalent of house-rent allowances have been found necessary in towns to prevent the wrong type of individual entering such a service as the police. It is advisable to investigate periodically, say once in ten years, the strength of the police force in order to enforce economy and to effect amalgamations of forces wherever economy would result. A similar investigation in regard to the cost of jails is also in some countries advisable, even at shorter intervals, since the cost of feeding prisoners is apt, unless most carefully watched, to vary from place to place with no apparent reason at all. In India, for example, there are wide differences in the cost of jails between province and province, and even between district and district.

CIVIL ADMINISTRATION

4. In recent years the cost of civil administration has increased for several reasons. In the first place, the rise in the

¹ *The Wealth of Nations*, Book V. chapter i. part ii.

² *Ibid.*, Book V. chapter ii. part ii.

cost of living made it imperative to adjust salaries and wages. Secondly, the increasing activity of governments in social services and in quasi-commercial undertakings resulted in a natural increase in the cost of administration. Another reason for the increase is that changes in the form of government have taken place. In 1905 the heads of provinces and members of the executive councils in India numbered twelve; to-day the number, including ministers, is fifty-one. The extra thirty-nine persons cost nearly Rs.24 lakhs a year in salaries. In addition there are the enlarged legislatures, increased secretariat staffs, and increased travelling allowances or touring charges. Finally, the increase may be due to a revision of the system of accounts. For example, part of the increase in the cost of general administration in India in 1921-22, as compared with the last pre-reform year (1920-21), was due to the fact that the cost of district magistrates, formerly debited to land revenue and justice, is now debited to general administration. As already noted, only administrative officers and staffs are included in the Indian statistics, and not all Government officials, *e.g.* those engaged in social services and in Government undertakings. In 1921-22 the Government of Bombay made an interesting inquiry into the actual staffs engaged in every activity on which the Government spent money, and it was found that 4.8 per cent was spent on the Imperial Services, mainly European. On the predominantly Indian branches the expenditure was 5.4 per cent on the provincial services, 20.2 per cent on clerks, and 1.6 per cent on miscellaneous servants such as messengers. Out of an expenditure of Rs.15 crores, 32 per cent went in the payment of personnel. The State civil servants in Great Britain and Northern Ireland also cost a similar percentage. Herbert Paul, in his *History of England*, well describes the position of the Civil Service. "The country", he says, "is governed in ordinary times for everyday purposes by these permanent members of the Civil Service, who work for both parties with equal loyalty, and in some cases with equal contempt."¹

5. The cost of collecting both direct and indirect taxes is also to be included under "Civil Administration". In India in

¹ Compare R. H. Hutton, a former editor of the *Spectator*—"Surely there is no bureaucracy in Europe so pleasant and so far from the domineering manner as the English".

1921-22, 5.3 per cent, or a little over half the percentage fifty years ago, was spent on this head.¹ The percentage varies considerably. In the case of income tax and customs it is less than 2 per cent ; for stamps and excise it is in the neighbourhood of 6 per cent ; for land revenue, 13.6 per cent ; for salt, 10.6 per cent including cost of production, and 9.5 per cent excluding cost of production ; for opium, 62.3 per cent, and excluding cost of production, 5.2 per cent. In recent years in India, while the cost of collection of income tax and customs has gone down remarkably, the cost of collection of salt and opium has considerably increased.² The cost is fairly evenly distributed among direct and indirect taxes, being 2.6 per cent on the former and 2.7 per cent on the latter for the year ended 31st March 1922. There are, it is obvious, remarkable variations in the cost of collection. It should be laid down as a principle that any reduction in the cost of collection which impairs the efficiency of collection is unwise. A slight increase in the cost of collecting income tax may far outweigh such additional cost and produce greater efficiency in collection. Recently the English Board of Inland Revenue has been obliged to establish a special Investigation Branch to deal with frauds. This, it is considered, will not only be a protection to the ordinary (and honest) taxpayer, but will result in a large increase annually in taxation, now fraudulently unpaid. The expenditure on civil administration in India in 1921-22 was 10.9 per cent of the total expenditure, as against 11.7 per cent in the pre-War year.³

DEBT SERVICES

6. The fourth main head of primary expenditure is debt services. In most countries the Great War has increased to a very large degree the expenditure on this head. In some countries the unproductive debt charges, especially in European countries, will for many years remain a very heavy charge. In India in the year 1921-22 ⁴ debt services were 15 per cent of the total expenditure, as against 12.2 in the pre-War year.

¹ *Vide* Tables III. and IV. App.

² *Vide* Tables III. and IV. App.

³ *Vide* Tables III. and IV. App.

⁴ The Indian financial year ends on 31st March, *i.e.* 1921-22, the twelve months ended 31st March 1922.

EXPENDITURE ON DEBT SERVICES IN INDIA
Percentage Expenditure to Total Expenditure

	20 Years ago.	10 Years ago.	Pre-War Year.	1920-21.	1921-2
Productive . . .	9.2	9.9	10.4	6.7	7.9
Unproductive . . .	3.3	2.6	1.8	5.5	7.1
Total	12.5	12.5	12.2	12.2	15.0

The following table illustrates at a glance the burden of pre-War and post-War debt services to the total expenditure :

EXPENDITURE OF GOVERNMENT ON PUBLIC DEBT IN VARIOUS COUNTRIES
Percentage to Total Expenditure

Country.	1913-14.	1918-19.	1919-20.	1920 21.	1921-22.
United Kingdom * . . .	12.4	10.5	19.6	29.2	36.8
United States	2.2	1.7	4.3	7.0	9.5
France	18.9	13.0	12.0	..§	..§
New Zealand †	24.4	32.6	30.5	27.9	..§
Union of South Africa †, ‡	27.9	28.6	25.5	21.5	..§
Canada †, ‡ . . . . .	..§	..§	..§	38.9	..§
Japan	36.9	32.2	27.7	18.5	18.4

* Figures are exclusive of expenditure from rates.

† Expenditure on debt charges expressed as a percentage of the total consolidated fund.

‡ Central and Provincial Governments.

§ Not available.

The large increase in the percentage under unproductive debt in India is noticeable since the pre-War year. The outlay on railways, irrigation works, telegraphs, and telephones are classed as productive debt, as will be seen from the detailed tables III. and IV. The productive debt is the equivalent of 4.0 years' purchase of the total revenue of the Central Government, excluding Provincial Governments and the unproductive debt of 1.6 years' purchase, a result which compares very favourably with the position of most countries in the world. This is due to the financial orthodoxy which has characterised the administration of India's public debt. All expenditure, normal or abnormal, other than

that on productive undertakings, was met from current revenues except (1) the War contribution of £100 millions (Rs.150 crores), (2) the outlay on the new Delhi Capital (Rs.8 crores), and (3) the revenue deficits of the last few years, which have been financed from borrowings. To this we shall return when dealing with public debts in Book IV. Borrowing is not a short cut to prosperity, and the temptation to fall into debt is one which every soundly-financed state strongly resists, except where the money is required for purposes which, after careful investigation, can reasonably be expected to be adequately reproductive.

CHAPTER VII

EXPENDITURE ON THE SECONDARY FUNCTIONS OF GOVERNMENT :

I. SOCIAL SERVICES

1. IN the previous chapter the primary expenditure of Governments was discussed. In this chapter we shall deal with secondary expenditure. In India secondary expenditure covers only a third, or slightly over a third, of the total expenditure from revenue. In the pre-War year it was almost 40 per cent. The importance of secondary expenditure in the twentieth century has increased, and will continue to increase, out of all proportion to that in the nineteenth century. Social services, such as education, public health, national health insurance, unemployment insurance, and old age pensions have, for example, in Great Britain, profoundly altered the direction of public expenditure. A similar movement has been at work in Australia and other parts of the British Empire. Twenty years ago the expenditure on education in India chargeable against central and provincial revenues was 1·2 per cent ; in the pre-War year, 3·7 per cent ; and in the year ended 31st March 1922, 3·8 per cent ; and the total expenditure on social services in the same period has increased from 3·9 per cent to 6·8 and 6·5 per cent respectively. In most countries the expenditure on Government undertakings, especially railways, posts, telephones, etc., has made a great leap upward.

EDUCATION : ITS IMPORTANCE

2. Money spent on education—and by education is meant not merely the imparting of knowledge but the education of character, of the faculties and activities generally—tends to increase

production by making the worker more intelligent and trustworthy. The labourer, as a result of education, contributes a larger share to the national income. Instead of a large population chiefly engaged in supplying itself with a bare existence, there is a population demanding, as well as receiving, more complex services. Adam Smith also showed a direct advantage to the State by the education of its citizens, because "the more they are instructed, the less liable they are to the delusions of enthusiasm and superstition which, among ignorant nations, frequently occasion the most dreadful disorders. An instructed and intelligent people, besides, are always more decent and orderly than an ignorant and stupid one."¹

3. In England and Wales primary education is free, and attendance at school between the ages of 5 and 14 years is compulsory, and by-laws may be made in any area requiring attendance up to the age of 15 years, either for children generally, or with certain exceptions. Provision must be made for advanced instruction, and also for practical instruction in cookery, laundrywork, housewifery, etc. The local education authorities also may arrange for nursery schools for children between the ages of 2 and 5. Employment of children under the age of 12 and street-trading under the age of 14 are prohibited. Similar regulations are in vogue in Scotland except that education is compulsory up to 15 years. In Scotland since the sixteenth century the parish schools have resulted in the percentage of illiterates being less than in England and Wales. Employment of children under 13 and street-trading under 17 are prohibited. Secondary education in Great Britain is provided so as to secure that children and young persons under 18 years of age shall not be debarred by inability to pay fees from receiving the benefits of any form of education from which they are capable of profiting. Under the Education Act, 1921, "the total sums paid to a local education authority out of moneys provided by Parliament and the local taxation account in aid of elementary education or higher education, as the case may be, shall not be less than one-half of the net expenditure of the authority recognised by the Board of Education as expenditure in aid of which Parliamentary

¹ *The Wealth of Nations*, Book V. chapter i. part iii. Compare *Report on an Enquiry into Working Class Budgets in Bombay*, G. Findlay Shirras, Bombay Government Central Press, 1923, p. 29 following.

grants should be made to the authority, and if the total sums payable out of those moneys to an authority in any year fall short of one-half of that expenditure, there shall be paid by the Board to that authority, out of moneys provided by Parliament, a deficiency grant equal to the amount of the deficiency, provided that a deficiency grant shall not be so paid as to make good to the authority any deductions made from a substantive grant".¹ Arrangements for borrowing on the security of the fund or rate out of which the expenditure on education is payable, and for repayment, are also provided for in the Education Act, 1921. The Treasury has directed that on loans granted out of the local loans fund on the security of local rates, $5\frac{1}{2}$ per cent per annum will be charged if the loans are repayable in not exceeding thirty years, and $5\frac{3}{4}$ per cent per annum in not exceeding fifty years.² In 1921-22, £65,000,000 was spent on elementary education in England and Wales, of which 41 per cent was from rates and 59 per cent from taxes; £18,000,000 was spent on higher education, of which 39 per cent was from rates and 61 per cent from taxes. Thus with a population of nearly 38,000,000 England and Wales spent on education over £83,000,000, or £2 : 4s. per head. The figures for the latest available year (1920-21) for Scotland were £12,000,000, of which 47 per cent was from rates and 53 per cent from taxes. Thus with a population of nearly 5,000,000 Scotland spent £2 : 8s. per head.

In the United States every state has a system of free public schools, supplemented by private and parochial schools. In 1920 the percentage of illiteracy in people above ten years of age had fallen to 6 per cent from 17 per cent in 1880, 13·3 per cent in 1890, 10·7 per cent in 1900, and 7·7 per cent in 1910. In 1920 the amount spent on public schools of elementary and secondary grades was nearly 883 million dollars or £177,000,000.

Next with regard to the Dominions. In Canada provincial governments control education and the principle of free education is followed, the funds being supplied in nearly all provinces by Government grants and local taxation. Education is more or less compulsory. In Australia education is secular, free, and

¹ Section 118, *vide* p. 278 Owen's *Education Acts Manual*, 22nd edition (Chas. Knight & Co., Ltd., London), 1923.

² H.M. Treasury Minute dated 1st April 1922, *vide* p. 314 Owen's *Education Acts*, 1923.

compulsory. It is under the control of each state. In New South Wales and Tasmania instruction is compulsory between 7 and 14 years, and in Victoria between 6 and 14 years. In the Dominion of New Zealand it is also compulsory between the ages of 7 and 14. In the Union of South Africa, under the South Africa Act, the control of education, other than higher education, rests with the four provincial governments. In Cape Province, for example, local school administration is conducted by school boards and school committees. Boards have the power to enforce attendance and in certain cases to allow free education. The sources of revenue are: Central Government, 69·76 per cent; fees, 25·17 per cent; local education rate, 4·66 per cent; other sources, 41 per cent. In the Transvaal, however, instruction in Government schools, both primary and secondary, is free, while in the Orange Free State fees are charged in all schools, exemption being granted under certain prescribed regulations, and attendance is compulsory up to Standard VI.

To sum up. When we look around and see the rewards of a sound education from the point of view of the State and its citizens, we see that capital invested in educational opportunities (in free schools, and even free colleges and universities) yields a princely return. There is, in the first place, the economic justification, viz. that the industrial efficiency of workers, male and female, is increased by such expenditure. A higher standard of living and a greater efficiency among the children of the poor result, and inequalities are levelled up. This expenditure is a sure means of adding to the national wealth and the national income. There is, on the other hand, the political justification for large expenditure on education. Self-government can only be successful in communities where there is a high level of literacy and, therefore, of intelligence. This high level is most easily and most cheaply attained through free public education. In the United States by far the largest item of expenditure is for public education, which outweighs in costliness even the expenditure on national defence.¹

Modern Governments, then, realise that there can be no raising of the standard of comfort and no enhancing of the value of labour and increased production until education is widespread and accessible; they also realise that there will be no sure

¹ Excluding War expenditure.

foundation for the superstructure of national advancement without the achievement of these results. Even without access to the purse of Fortunatus, it is realised that sound and durable instruction must be brought to the doors of the people. In India to-day there is no more pressing claim than more and better education. Our new Constitution of 1919 to a large degree requires as its base an intelligent electorate. Responsible government is, in fact, a pyramid that can only grow with its base, and without an enormous development of national education this task is an impossibility. Out of a population of 247 millions in British India, 5·3 millions or 2·1 per cent are enfranchised. Only 22·6 millions or 8·2 per cent, a surprisingly low figure, are literate, *i.e.* they can read and write a letter in one language. Moreover, our education at the moment is very badly balanced. The still small voice of primary education is scarcely heard, while the proportion in secondary schools, when an allowance is made for the fact that females can be virtually left out of the reckoning, is far greater than the corresponding figures for England and Wales. The figures for university education are still more interesting—no less than ·025 per cent of the population as against ·054 per cent of England and Wales—especially when the Indian figure has practically to exclude, unlike the latter which includes, the female population. The problem, then, is of the most vital import, upon which India must set to work at the earliest possible moment. Our task is to introduce into the masses in our rural areas and into the proletariat of our towns a degree of education which will fit them, in ever-increasing numbers, to be the basis of our future political structure. In Plato's words, true education is that which "makes a man gladly pursue the ideal perfection of citizenship, and teaches him how rightly to rule and how to obey—this is the only education which, upon our view, deserves the name". The foundation of a democratic state is liberty, Aristotle tells us, and he adds, "one part of liberty is to govern and be governed alternately". Does the electorate, in Aristotle's words, "know how to command as well as to obey? To do both these things well is the virtue of an accomplished citizen." As far back as September 1921 the Viceroy (Lord Reading), in addressing a joint-session of the Legislature, referred to this weak spot. Twelve months later he repeated his warnings. When

addressing a joint-session in Simla in 1923 he said : " Last year I impressed on you that the electorate required education. I have the same advice to repeat to you now, but I repeat it with more force and insistence." It seems that nothing short of a complete overhauling of the national system of education will suffice. A system of sound primary education is required which will aim at imparting such simple knowledge as will be of permanent value to the taught in their daily work and help them to avoid the petty tyrannies of life which ignorance engenders. As the great Richelieu said in the seventeenth century : " When I regard the majority of those who profess to teach, and the multitude of children who are taught, I seem to see an infinite crowd of sick who need nothing but a draught of clear, sweet water for their healing. Yet so uncontrolled is the thirst which affects them that, accepting indifferently all cups which are presented to them, the greater of them drink from tainted, and some even from poisoned, sources ; thus increasing their thirst and their malady, in place of assuaging both." The pure, sweet water of primary education would heal the malady. But it must not stop at primary education. Secondary schools should be the recruiting ground for those who are urgently wanted in commerce, banking, industry, and other responsible posts. If they possess a sound general education and are apprenticed to business they will have an economic value. Here there is material for increasing the wealth of the country. The universities, too, should shake off the incubus of the ill-prepared student and pursue knowledge not for the sake of the information to be acquired, but for the extension of knowledge and the attainment of exact truth. As Lord Brougham said a century ago : " A man should know something of everything and everything of something". All **this** means money and new sources of taxation, and not a paltry sum of Rs.18.38 crores (£12.3 millions), which was the entire expenditure in British India in 1921-22 on education, or twelve annas or one shilling per head of population, a miserably small and inadequate sum.

OTHER SOCIAL SERVICES

4. Expenditure on other social services includes expenditure on religion, public health, unemployment insurance, national

health insurance, poor relief, and similar services. In an earlier chapter we referred to the change which took place in twentieth-century finance in Great Britain by the breaking away from the traditional finance of Gladstone in the nineteenth century, when such Acts as the Old Age Pensions Acts, 1908 to 1919, and the National Insurance Acts, 1911 to 1921, were placed on the Statute Book. Previous to that period the social services on which the State mainly devoted itself were education and poor relief.

RELIGION

5. It is unnecessary here to enter in detail into the question of expenditure in England on religion, because the amount is not large, and modern thought is in favour of the view that State revenues can on the whole be better devoted to other objects. Experience in the United States and in the Dominions has all pointed in this direction, especially in the former. In Great Britain and on the Continent of Europe, as in France, this enlightened view continues to grow in spite of vested interests. In France no religion is recognised by the State. By the law promulgated on 9th December 1905, the Churches were separated from the State, and the adherents of all creeds were authorised to form associations for public worship. Ecclesiastics over forty-five years of age and of over twenty-five years of service remunerated by the State were entitled to a pension, and all other ecclesiastics were to receive grants during periods of from four to eight years. These were purely transitory measures. All buildings used for public worship and as dwellings in this respect were made over to the associations for public worship. Similarly, from 31st March 1920, the Church in Wales and Monmouthshire was disestablished under the Welsh Church Acts, 1914 and 1919, and the property and £1,000,000 provided by Parliament were assigned to the Welsh Commissioners, a temporary body, for distribution to a body called the Representative Body representing the Church, and to certain other authorities, including the University of Wales.

CHAPTER VIII

EXPENDITURE ON THE SECONDARY FUNCTIONS OF GOVERNMENT :

I. SOCIAL SERVICES (*continued*)

1. THE English poor law in the early part of the nineteenth century is a classic instance of indiscriminate charity and its many attendant evils. The method by which such charity was dispensed was virtually a demand for paupers. Adam Smith wisely eliminates in his treatment of expenditure all reference to poor relief as a recognised charge on public revenues. It is still a very doubtful question of financial policy. The history of poor relief, from the passing of Gilbert's Act, 1782, to the re-establishment of the workhouse test, shows how those who lived on charity were in many districts better off than those who did an honest day's work. It also showed the baneful evils of the parish allowance for each child, as it constituted a premium on the increase of numbers. It therefore not only crippled industry, but affected public morality.¹ Fifty years of liberal policy in poor relief on these lines made the burden of pauperism felt for many years. At the present time in the United Kingdom relief is given, under certain conditions, to paupers in their own houses or in workhouses or poorhouses.² The law is administered by the Ministry of Health,³ through Boards of Guardians elected for this purpose. The expenditure by local authorities in England and Wales during eighty-six years ended

¹ Vide *Report of Poor Law Commissioners*, 1834.

² Guardians, however, according to the Court of Appeal decision in 1900 on the Merthyr Tydfil judgement, have no power to grant relief out of the rates to able-bodied men on strike, who might, had they chosen, have obtained work, although the Guardians can give relief to their wives and children.

³ Previous to 1st July 1919 (when the Ministry of Health came into being), the office was known as the Local Government Board.

March 1920 was approximately 780 million pounds sterling. For the year ended March 1920 the expenditure in England and Wales was nearly £24 millions, and over £2 millions in Scotland. Generally speaking, if poor relief is necessary, it should be given indoor, and the reform of the habitual pauper should be regarded somewhat in the same way as the reform of the habitual drunkard or criminal. The procedure followed in some other countries is not without interest. In Germany the general principles are laid down in the Imperial law of 30th May 1908. In urban municipalities the administration is carried out by a special committee, the president of which is the burgomaster, and in rural communes poor relief forms part of the ordinary local business of the district councils. A German in distress must be relieved by the local union ¹ in which he becomes destitute, and the cost must be refunded by the local union to which he belongs, or by the appropriate provincial union. Poor-rates are not as a rule levied. In France poor relief is given through public *bureaux de bienfaisance*, and also through private and ecclesiastical sources. The communes and the departments look after the poor, and Government exercise general supervision. Endowments, communal contributions, public and private charity are the sources of the bureaux funds. In Japan legislation in 1899 provided that the minimum amount of prefectural funds for "the relief of sufferers from extreme calamity" shall be half a million yen, and funds below that amount are to be made up by the Treasury. When the amount of relief exceeds 5 per cent of the funds at the beginning of the financial year, one-third of the amount granted is to be supplied from the Treasury. In New Zealand charitable relief and hospitals are subsidised by the Government in the following manner, which is of considerable interest: bequests at the rate of 10s. in the pound; voluntary contributions, 24s. in the pound; and contributions by local authorities, according to a sliding scale, ranging from 12s. 3d. in the pound to 24s. 3d. in the pound. In India there is no system of poor relief. In times of famine, however, relief is necessary, and for this purpose each province has to set aside a fixed sum (which is not uniform, but varies according to the liability of

¹ Under the law there are local unions (*Ortsarmenverbände*) and provincial unions (*Landarmenverbände*). The former usually is a commune and the latter a large administrative division, such as a circle, or a whole state.

each province to famine¹) year by year. This sum is devoted to actual relief or to insurance against famine, *i.e.* to the construction of protective irrigation works, or other works for the prevention of famine. Any balance unspent at the end of the financial year is placed to the credit of the Famine Insurance Fund of the province, a fund which consists of unexpended balances of the annual assignments for each year, with accrued interest on these balances.²

2. The second half of the nineteenth century was, as we have seen, remarkable for the teaching, especially in Germany, of the increased activities of the State. Even before the Franco-Prussian War, writers of the school of Wagner, Schmoller, and other "Kathedersocialisten" profoundly affected the public mind, and their views on State insurance were slowly but surely gaining general acceptance. In the eighties of the last century Germany introduced social insurance, which comprised compulsory insurance of workmen against sickness, insurance against accidents by employers, and the insurance of workmen against old age and infirmity. Denmark followed in 1891 with a law on old age pensions. The question in Great Britain received from statesmen, writers, and others the attention in the last twenty years of the nineteenth century which its importance undoubtedly merited. It was considered, for example, in the Report of the Select Committee on National Provident Insurance (1887), the Report of the Royal Commission on Aged Poor (1895), the Report of Lord Rothschild's Committee (1898), the Report of the Select Committee on Aged Deserving Poor (1899), and in the Report of the Departmental Committee about the Aged Deserving Poor (1900). The proposals came within the sphere of practical politics before Mr. Asquith pledged in 1907 in his Budget Speech the Liberal Government to start a scheme of

¹ Under Schedule IV., "Other Rules under the Government of India Act", 1919, Bombay provides an annual assignment of over Rs.63½ lakhs, the Central Provinces Rs.47 lakhs, the United Provinces over Rs.39½ lakhs, Bihar and Orissa over Rs.11½ lakhs, Madras over Rs.6½ lakhs, the Punjab nearly Rs.4 lakhs, Bengal Rs.2 lakhs. Burma provides Rs.67,000 and Assam Rs.10,000. When the accumulated total of the famine insurance fund is not less than six times the amount of the annual assignment, the local government may suspend temporarily the provision of the annual assignment.

² The Famine Insurance Fund forms part of the general balances of the Central Government, which pays interest on the average of the balances in the fund on the last day of the year.

old age pensions. These pensions came into force from 1st January 1909, the Old Age Pensions Act having been passed in the previous year. Provision was also made under the National Insurance Acts, 1911 to 1921, for compulsory insurance against loss of health, and, in certain circumstances, against unemployment. Australia in 1908 and New Zealand in 1898, of the self-governing Dominions, introduced old age pensions. Australia, too, possesses a system of health insurance on a non-contributory basis in the form of invalid pensions and maternity allowances, while New Zealand and Canada, following the well-known examples of Germany and Great Britain, also possess employment offices or labour bureaux. France in 1905 and Spain in 1908 adopted old age pensions. In 1911 Switzerland adopted a scheme of insurance against illness, but not of a compulsory kind.¹ Holland in 1916 introduced a scheme of unemployment insurance. Three years later Poland began a scheme of health insurance which was obligatory for wage-earners. We sometimes are apt to minimise the extent to which the State's activity expanded in the last two decades. We have only to mention that even in Iceland (*mirabile dictu*) there is an old age pension fund in every community, contributed to by the community and the State.

3. A glance at the Budgets of these countries shows the importance of these comparatively new items of expenditure. In Great Britain the benefit paid in 1922 under unemployment insurance was £48 millions. The contributions to the unemployment fund were over £46 millions, of which £18 millions were from employers, £16 millions from employees, and £12 millions from the State. The number of persons covered by the scheme was 12,000,000. The number of insured persons under the Health Insurance Scheme in England and Wales in 1922 was about 15,000,000. Old age pensions for the year 1921-22 amounted to £26 millions, and the number of pensions paid was a shade over a million (366,000 to men and 663,000 to women). In Germany in 1919 nearly 17,000,000 were insured against sickness, 23,000,000 against accident, and 17,000,000 against invalidity. Under the French Old Age Pensions law of 1910,

¹ Insurance against accident, however, is compulsory for all officials, employees, and workmen of all concerns and trades which are within the Federal Liability Law.

8,300,000 were registered on 1st July 1920. These facts speak for themselves.

4. There is an unusual want of uniformity in the payment of old age pensions ; *e.g.* in Great Britain, Australia, New Zealand, and Denmark they are non-contributory, while in France and in Germany they are contributory. The case for the payment of gratuitous pensions is that the class from which pauperism is drawn would not benefit unless they were non-contributory. Charles Booth, in his *Old Age Pensions* (1899), was the protagonist of this view. On the other hand, Mr. Chamberlain opposed strongly this view, and held that it should be contributory and voluntary. Speaking in May 1899, he described Booth's universal scheme as " a gigantic system of outdoor relief for every one, good and bad, thrifty and unthrifty, the waster, drunkard, and idler, as well as the industrious ". There is, too, no exact uniformity in regard to the age at which pensions should be paid. In some countries 70 years and over has been taken as the age. In Great Britain the age is 70 years and over, except for blind persons, where the minimum age has been reduced to 50 years. In Australia, New Zealand, and France the qualifying age is 65 years. It is a good plan to decrease the pension as the income advances. The pension in Great Britain, for example, varies from ten shillings weekly when the yearly income does not exceed £26 : 5s., to one shilling when the yearly income is £47 : 5s., or up to £49 : 17 : 6, no pension being payable above this sum. The weekly pension decreases by two shillings for every £5 : 5s. by which the limit is exceeded. The British national health insurance scheme includes both those who are compulsorily insured, known as employed contributors, and those who may become voluntary contributors. The benefits include medical treatment, sanatorium treatment, payments during sickness (ordinary rate, 15 shillings per week for men and 12 shillings for women), disablement (7 shillings and 6 pence per week), and in the case of women a payment of 40 shillings on confinement. Under the British unemployment scheme, which, like the national health insurance, is contributory on the part of the employer, employee, and the State, the ordinary benefit consists of a weekly payment of 15 shillings for men, 12 shillings for women, and half these amounts to contributors under 18, during a maximum period, under certain conditions, of 26 weeks

per year. In addition to insurance by the State there are, of course, friendly societies or trade unions which make grants to members.

5. To sum up, national health insurance, including old age pensions, imposes a considerable and increasing burden. Some countries find it more expedient to devote their expenditure to those most important social services—education and public health, and until education is widespread and sanitation well advanced it is unwise to incur expenditure on national insurance and old age pensions. A burden upon national industry is imposed which may hamper competition in world markets and react to the detriment of those classes which it is intended to benefit. Want, on the other hand, is to a considerable extent relieved and pauperism prevented.

CHAPTER IX

EXPENDITURE ON THE SECONDARY FUNCTIONS OF GOVERNMENT :

II. GOVERNMENT OR PUBLIC UNDERTAKINGS, ETC.

1. THE next main group of public expenditure is Government or public undertakings, and this includes railways ; irrigation works ; other public works such as roads, canals, and buildings ; posts and telegraphs ; mints ; stationery and printing ; forests ; ports and pilotage ; scientific departments ; and miscellaneous undertakings such as patents, exhibitions, and factory inspection. In India this group of expenditure is from one-fifth to one-fourth of the gross expenditure from central and provincial revenues. In the pre-War year it was 25·7 per cent, and in the year (1921-22), 20·8 per cent.¹ In other countries this percentage may be much less or much greater, according to local circumstances. In India, for example, railways belong to the State ; so do irrigation works, both productive and unproductive.² One hundred thousand square miles of precarious country are rendered certain of their crops, and this area will soon be half as large again. The value of the crops irrigated in 1920-21 was £156 millions, or double the capital cost of the works.

2. Expenditure on Government or public undertakings is no longer regarded as a leading function of governmental activity, as are defence, law, and order. In the eighteenth century it was thus regarded, but Adam Smith and the Physiocrats, especially "the noble" Turgot, showed that this was wrong, although there were certain definite duties for the State to perform in

¹ *Vide* Table III. App.

² Productive works are those which within ten years of the completion of construction produce sufficient revenue to cover their working expenses and the interest charges of their capital cost. All other works are classified as unproductive. The classification based on the source from which funds are allotted for the construction of these works has been abandoned.

this direction. Indeed the State, according to Adam Smith, had to undertake such public works as were too great for individuals and yet necessary to the community. There are those which facilitate the commerce of the country either as a whole or, as Adam Smith added in the 1784 edition, in particular branches. In India the State has undertaken such works only on the clearest of reasons, the most important of which is maximum advantage. Continuous interference, or, worse still, petty interference at every turn, is avoided. With the development of social consciousness the tendency for outlay on public undertakings is to increase. The development of industries, for example, means increased expenditure on industrial research, on factory inspection and the welfare of labour, on the means for settling labour disputes, and on the collection of full and accurate statistics. Were Adam Smith alive to-day he would, almost certainly, have enlarged his category of public works which the sovereign power should undertake.

3. In regard to these undertakings the financier has to pay special care to one or two aspects of policy. In the first place, such concerns should be run on strictly commercial principles. It may be advisable to give railways, for example, a budget of their own, apart from the Central or Federal Budget, the railways paying to Government for the loan of its capital a fixed return annually. This is, it is considered by many, a necessary reform in Indian finance. The Acworth Committee, for example, reported as follows :

We wish to disclaim any idea that the railway organisation should be independent, an *imperium in imperio*. This is quite out of the question. The Indian Government owns the railways ; the Indian Government must control them. But that is no reason why the control should take the form which is found suitable in respect of other departments of the State. What we propose is in outline that the railways should have a separate budget of their own and assume the responsibilities for earning and expending their own income. The first charge on that income, after paying working expenses, is interest on the debt incurred by the State for railway purposes. The amount of this debt is known—we may call it roughly £252,000,000.¹ The annual liability of the Indian Govern-

¹ Paragraph 74 of the *Report of the Committee appointed by the Secretary of State for India to enquire into the Administration and Working of Indian Railways*, vol. i.

ment for the interest is £6,700,000. Whether the railways should pay precisely this amount, or a larger amount, in consideration of the fact that in early years taxation had to be imposed to meet that portion of the interest which the railway receipts did not then cover, or a smaller amount, in consideration of the expenditure which the railways have since incurred for non-railway purposes, is a matter for argument. We have no wish to express a positive opinion, though we think there is much to be said for letting bygones be bygones and fixing the payment to the Government at the same sum that the Government has itself to find at the present time for interest on the railway debt. The point is that the Railway Department, subject to the general control of Government, once it has met its liability to its creditors, should itself regulate the disposal of the balance, and should be free to devote it to new capital purposes (whether directly or as security for new debt incurred) or to reserves, or to dissipate it in the form either of reduction of rates or improvement of services.¹

The condition of affairs hitherto prevailing in India has tended to an alternation between raids by the railways on the taxpayer and raids by the taxpayer on the railways. In 1924 a new agreement was arrived at according to which "the taxpayer, instead of paying the whole of the expenses and taking the whole of the incomings of the railways, will enter into a bargain with the railways to receive from them (a) a sum sufficient to pay in full the interest on the capital he has invested in the commercial lines, (b) an additional dividend of five-sixths of 1 per cent on that capital, and (c) a share of one-fifth of any surplus earnings that may be secured in addition. In return, the railways will be left to carry on their business with the right to retain any surplus over and above what they pay to the Government and to apply it to railway purposes, first of all for creating reserves and then by using those reserves to improve the services they render to the public, and reduce the price which they charge for those services."² In most countries at the present time it is recognised that efficiently administered railways bring with them many indirect advantages. With good railway communications, land values improve ;

¹ Paragraph 74 of the *Report of the Committee appointed by the Secretary of State for India to enquire into the Administration and Working of Indian Railways*, vol. i.

² Finance Member's Budget Speech. Vide *Gazette of India Extraordinary*, 29th February 1924.

trade, commerce, and industry are fostered ; and, as a result, public revenue benefits. It is often, however, forgotten that efficient railway administration depends on a continuity of a sane and progressive policy, which in turn depends on an intelligent programme prepared well in advance and assisted by timely contracts, and free from vexatious changes resulting from the exigencies of the general finance of government. Secondly, there is the underlying principle that the relation of working expenses to revenue should be so adjusted as to provide for an adequate return on the capital invested. Thirdly, adequate financial provision should be made annually by the railways for the maintenance and renewal of the permanent way and rolling stock. The Acworth Committee on Indian Railways observed that what was unspent on maintenance and renewals during the War should have been carried to a reserve, and the accumulated funds spent when materials were again available. When funds so ear-marked are debited to working expenses they would be carried to a suspense account to be drawn on to meet current requirements. Any unspent balance would be carried forward at the end of the year. Unless this is strictly enforced, it is difficult to judge whether there is an adequate return on capital outlay and an adequate check on ordinary working expenses.¹ It is also advisable to pay very special attention to the form of accounts and to the statistics. In order that financial considerations should be given the weightiest consideration before expenditure is actually incurred, financial advisers of independent authority are of advantage. Similarly in Posts and Telegraphs and other quasi-commercial concerns, steps must always be taken to maintain (by a regular and systematic check) a strict relation between the staff employed and the amount of work done, and to improve the average output. The value of outside tenders for the construction of all large buildings, the cutting down of constructional and general stores to a minimum of so many months' supply, the charging of "economic" rents for all accommodation provided, care in the placing of contracts, and a general but severe control of existing and future expenditure, cannot be too highly assessed.

¹ See Chapter XXXII.

OTHER EXPENDITURE

4. The last group of public expenditure is an omnibus head, and will vary in different countries. It includes, in the case of India, what cannot be included under the main groups, *e.g.* allowances under treaties, refunds, drawbacks, and certain civil superannuation and pension charges. This head is an insignificant one, as it must be necessarily.

CHAPTER X

THE DISTRIBUTION OF CENTRAL, PROVINCIAL, AND LOCAL EXPENDITURE

1. THE distribution of public expenditure between the Central or Federal Government, Provincial or State Governments (where these exist), and local authorities is frequently, if not always, the result of historical conditions. In the United States constitution, for example, the powers of the Federal Government are set out, and all powers of government not taken over by the Federal Government belong to State Governments. The British North America Act of 1867, framed shortly after the American Civil War, enumerated the powers of Provincial Governments, and all powers not so enumerated were to be exercised by the Dominion or Central Government. It is true that the British North America Act enumerates a series of subjects pertaining to the Dominion Government. This is "for greater certainty, but not so as to restrict the generality" of the legislative power "with regard to all matters not coming within the class of subjects of this Act assigned exclusively to the legislatures of the provinces". Similarly, in the Indian Constitution of 1919 central and provincial subjects are given, but it is expressly provided that all matters exempted from inclusion among provincial subjects, and "all other matters not included among provincial subjects," belong to the Central Government. For historical reasons, too, the most important sources of revenue, direct taxes, belonged to the individual component States of the German Empire, while the Empire itself had to rely on indirect taxation. Germany paid the penalty for delaying to adapt, before the outbreak of war, the needs of the Imperial Budget to

the changing conditions, and therefore it had to depend on enormous loans. In Great Britain and New Zealand the division between central and local expenditure is also traceable to historical factors. The modern history of rates in the former begins with the poor-rate of 1572, 1598, and especially 1601. These rates are all levied according to the annual value of property rateable to the poor-rate, either as part of the poor-rate or on the same lines as the poor-rate. In some countries, as in India, a possible widening of provincial and local powers, and a corresponding curtailment of the Central Government's powers, *i.e.* a distribution of functions, especially in matters of a more or less local interest and importance, is at work. While the advantages of a strong Central or Federal Government are as clear as sunlight, a wise decentralisation for financial reasons alone is invariably essential. No better illustrations of this principle can be found than in the Commonwealth of Australia Constitution Act of 1900, the South Africa Act of 1909, and, to a less extent, in the Government of India Act of 1919. In these Acts the golden workable mean appears to have been attained in view of the local conditions peculiar to each country. In some countries, however, there is a "tightening up" on the part of the Central Government at the expense of provincial or local authorities. Here again this is at the bottom obviously historical. The powers of an Australian State, an Indian or Canadian provincial government, an American State or "Commonwealth", or a Swiss canton are very much greater than those of the English county. The basis of the French canton, *arrondissement*, and department, or the Prussian district, circle, and province, is historical, and the centralised system of the former and also of Italy goes back to the eighteenth century and earlier.

2. The importance of central, provincial, and local expenditure varies, as is to be expected, in different countries. Before the War, in Great Britain central and local expenditure (*i.e.* local rateable expenditure, excluding expenditure from loans) was in the proportion of 4·6 : 5·4. Since then the proportion has changed, and approximately 71 per cent of public expenditure in 1921 was central, and the remainder, 29 per cent, local. The expenditure from central sources was £1079 millions and the rateable expenditure about £450 millions, inclusive of about

£30 millions received from the Exchequer.¹ The proportionate expenditure expressed in the form of percentages is as follows :

PROPORTIONAL EXPENDITURE—CENTRAL, PROVINCIAL, AND LOCAL *

Country.	Year to which Percentages refer.	Central.	Provincial.	Local.
Great Britain and N. Ire- land	1921	71	..	29
India	1921	57	32	11
Australia	1921	39	53	8
New Zealand	1921	72	..	28
South Africa	1920	56	20	24
Canada †	1921	75	25	..
France	1920	89	..	11
U.S.A.	1922	50	15	35
Germany †	1921	95	5	..

* In this statement care has, as far as practicable, been taken to count figures only once, e.g. expenditure paid out of central or provincial revenues to local authorities has been included only under local authorities. Exact uniformity in the table can scarcely be looked for.

† Central and Provincial only.

3. In the above table it will be seen that in all countries, with the exception of Australia, the Central Government is responsible for the larger part of public expenditure. This is not unnatural, as the Central Government has to do those things, such as defence, where unity is essential or where a wide outlook must be taken. Moreover, the Central Government has a better trained secretariat or body of officials which a local authority does not ordinarily possess.² There are, however, certain heads of expenditure which are better controlled by local than central or State authorities. Minute supervision is required in expenditure on lighting, sewers, and the poor-rate, and this is often, but not invariably, done far more efficiently by local authorities where local patriotism exists. In New South Wales, for example, hospitals, benevolent institutions, public libraries, parks, and

¹ "The fact that an overburdened Central Government hands over some of its functions to Local Government which is often in a position to discharge them more economically and efficiently, is no reason why the taxpayer at large should be relieved at the expense of the less fortunate groups of rate-payers. Government, therefore, makes an annual contribution from the public purse towards the needs of local authorities" (Higgs, *National Finance* (Methuen & Co.), p. 88).

² In the supreme Government in India secretaries are appointed for three years only and selected from the various provinces.

churches are under the control of municipal and shire councils. These councils are permitted to borrow up to 20 per cent of the unimproved value in municipalities, and the loans are guaranteed by the Government. Special local and loan rates are imposed on the improved or unimproved value as the council prefers. The rateable value of coal mines, for example, is fixed at 50 per cent of the gross value of the average annual output for the preceding three years, and other mines are assessed at 40 per cent for the same period. In the self-governing Dominions it is customary for the Central Government to subsidise the provinces, as, for example, in Australia, South Africa, and Canada. In India the reverse is the case. The Provincial Governments make a fixed annual assignment (which is a fixed prior charge on provincial revenues) to the Central Government. It is hoped that in a few years it will be feasible to wipe out such assignments completely, especially from the fact that the provincial revenues are less elastic than those of the Central Government, and also because the provinces must devote in the near future large sums for primary education and other nation-building activities.

4. What then should be the broad lines of the division between Central or Federal, Provincial or State, and local expenditure? A precise line of demarcation is of course impossible. It will be advisable to examine the Budgets of various countries and to draw from this examination the principle or principles on which the division has been made in practice.

In all Federal Governments security is their primary function, and therefore expenditure on defence is retained by the supreme or Central Government. In the United States, India, and the self-governing Dominions, defence, a subject of the most vital and general interest to the country as a whole, is rightly a central subject. Customs, including tariffs, shipping, immigration, foreign relations, post offices, telegraphs, including wireless telegraphy, census and statistics, and the country's debt apart from the debt of State and local authorities are suitable subjects of federal or central expenditure. Other subjects which may conveniently fall within this category are the civil and criminal law of the land, together with central police organisation. It is in the long run a gain to a Federal constitution to have uniformity throughout the country in these matters.

State or provincial items include education, the conservation of health¹ and sanitation, law and justice, including prisons and police, public works such as irrigation works, roads, bridges, and provincial buildings, industries, labour, payments for interest and sinking funds in connection with State debt, and similar payments. Anything affecting local self-government, such as the constitution of municipalities, district boards or similar local bodies, is a fit subject of State or provincial expenditure.

Local expenditure ordinarily should include expenditure on education, police, a fresh and adequate supply of water, sanitation, lighting, roads, tramways, cemeteries, crematoria or burning ghats, markets, parks, and similar works and services. Of the rate expenditure of local authorities in Great Britain for 1921-22, estimated at £192 millions, poor relief and education each accounted for £40 millions, police for £11 millions, and other expenditure for £101 millions. Poor relief, education, and police together accounted for 47 per cent of such expenditure. In India for the financial year ended 31st March 1920 the aggregate expenditure of municipalities (of which there were 739 with a population of over 17 millions) was Rs.2100 lakhs (£14 millions), including debt expenditure of Rs.11 lakhs (£73,000). The aggregate expenditure of district and sub-district boards in the same period (including debt items) was Rs.990 lakhs (£6.6 millions). During this period 23.8 per cent of the gross expenditure of municipalities, district and sub-district boards was spent on public works, including roads, 11.8 per cent on education, 15.0 per cent on sanitation, hospitals, etc., and 44.7 per cent on debt and miscellaneous expenditure. In New Zealand 72.3 per cent was devoted to public works, 12.5 per cent to loans, and 5.7 per cent to management.

From the classifications given above it will be evident that there is no absolute uniformity between country and country, owing mainly to historical causes. In some cases, as in Canada, Australia, and South Africa, the Dominion or Federal Government had a later birth than that of the provinces or States. This is not an invariable rule, as, for example, in India, where there has been for long a powerful Central Government. The long list of Governors-General from Warren Hastings shows this

¹ Including hospitals, dispensaries, asylums, and provision for medical education.

to have been the case, and this supreme Government, with the acquisition of new territory and general economic progress, has gradually delegated powers to local administrations, especially where a high degree of co-ordination appears to be, in changed circumstances, unnecessary. No uniform division exists between central or federal, provincial or State, and local expenditure. Take, for example, education and police. Education is both State and local expenditure, since education is of general interest to the community (and therefore of importance to the State as a whole) and of special or local interest as in elementary education. In Prussia and other States of the Deutsches Reich, where education is compulsory for children from six to fourteen, the free elementary schools (Volksschulen) and the middle schools of the towns (Burgerschulen and Höhere Burgerschulen) are maintained by local rates with grants from the State. In addition to these the well-known gymnasien (which prepare in a nine years' course pupils for the universities) and technical and normal schools are also met from State and local resources. In the highest spheres of education it is not possible to expect local rates to bear a large proportion of their cost—at any rate in cases where such institutions are national or provincial in character, and therefore rightly a charge on national or provincial revenues. Expenditure on police is sometimes similarly partly State and partly local. While the State is vitally interested in the preservation of law and order, it cannot be doubted that local authorities, if animated by a real spirit of local self-government, can supervise the control of the police, only general supervision being kept in the hands of Government. Thus in Great Britain local authorities possess a considerable control over their police, but the Home Office, Whitehall, exercises general supervision. In other cases the whole of the expenditure on police is State expenditure, on the principle laid down by John Stuart Mill in his *Representative Government* (1861) that “it would not be a matter personally indifferent to the rest of the country if any part of it became a nest of robbers or a focus of demoralisation, owing to the maladministration of the police”.

5. It is not the duty of State or provincial governments to relieve local authorities of expenditure that rightly pertains to local authorities. In some countries, notably in India, municipalities have been accustomed to look to Government for grants,

and to shun improving the machinery of rating and valuation. In Ahmedabad, for example, with a population of 300,000 and no less than 64 cotton mills, it is very doubtful whether local rates should not bear the full cost of renewing, for example, machinery for pumping water, instead of seeking and obtaining *in forma pauperis* subventions for this and for other similar purposes such as hospitals and other local institutions. Grants have been given, notwithstanding a rise in recent years of at least tenfold in land values. In short, expenditure should have been met by increased local rates on real property in order to meet what is of particular value to the community. The example of the United States in this respect is of interest. The main expenditure in individual States is undertaken by the local authorities in counties, townships, or school districts.

6. To sum up, no clear line of demarcation is possible between central, provincial, and purely local expenditure. The differences that exist are largely, very largely, the result of historical conditions. As a general rule it may be stated that where the interests of the State as a whole are concerned (*e.g.* in defence), then the expenditure is undoubtedly central and not local. Where, too, in addition to the good of the whole community, there are advantages in uniform action, then the expenditure should be met from central (or State) sources. In cases where particular interests are paramount, or detailed local supervision required, local authorities should be the spending authority.

CHAPTER XI

EXPENDITURE CHARGEABLE TO CAPITAL

1. THE problem of expenditure chargeable to capital has received unusual prominence in recent years mainly, if not quite entirely, owing to the Great War. What expenditure on the part of public authorities should be incurred out of capital, and what expenditure should be incurred from revenue? What are the general principles on which capital expenditure is to be incurred? Should non-productive expenditure invariably be met out of revenue, and out of revenue only? For the present we shall attempt briefly to answer these interesting points of public expenditure.

2. The importance of the problem may be seen from the detailed tables (XXV.-XXVII.) in Appendix, showing the public debt of various countries before and after the War. The general results may be conveniently summarised thus :

Country	Currency, etc.	Total Debt in		Equivalent in Years' Purchase of Revenue.	
		Pre-War Year.	1921-22.	In pre-War Year.	To-day (1921-22).
India	Lakhs of Rs.	461,09	722,65	3.6	3.6
United Kingdom .	Million £	708	7,721	3.6	6.9
Canada	"	144	625 *	5.2	8.7
Australia	"	312	860 †	4.9	5.8
South Africa . . .	"	126	192 †	7.3	5.9
New Zealand . . .	"	100	206 †	8.1	6.1
United States . .	Million \$	2,912	25,952 ‡	3.9	3.9
France	Million fr.	33,637	317,531	7.1	13.6
Belgium	"	3,739	34,234 †	4.9	16.3
Japan	Million yen	2,545	3,593 †	4.3	2.6
Italy	Million lire	13,798	72,574	5.1	3.1

* Year 1918-19.

† Year 1920-21.

‡ Year 1919-20.

Before the War Great Britain's debt was £15.4 per head ; to-day (1921-22) it is £163, an increase of 987 per cent, or an amount no man in his senses would have dared to prophesy some years ago, even allowing for changes in the taxable capacity of its people. The debt of other countries per head has increased as follows :

	Debt per Head.		Increase Per Cent.
India . . .	From Rs.19 in 1913-14 to	Rs.29 in 1921-22	53
Canada . . .	£18.6	£71 in 1919	282
Australia . . .	£69	£155 in 1920-21	125
New Zealand . . .	£92	£169 in 1920-21	84
South Africa . . .	£20	£27 in 1920-21	35
France . . .	Fr.849	Fr.8100 in 1921-22	854
Belgium . . .	Fr.504	Fr.4588 in 1920-21	810
Italy . . .	L.391	L.1870 in 1920-21	378
Japan . . .	Y.48	Y.64 in 1921-22	33

3. There are some writers on public finance who hold that to charge to revenue what should be charged to capital is a great injustice to the taxpayer. It is, in addition, an instance of very faulty book-keeping. German writers of the middle and latter half of the nineteenth century, such as Dietzel, Stein, and Wagner, would have all extraordinary expenditure met from loans because of a capital investment. On the other hand, there are others who hold that all extraordinary expenditure, if unproductive, should be met from income, and unless it can thus be met, should not be incurred. Gladstone attempted unsuccessfully to finance England's war expenditure in the Crimea without loans. He believed that nations should meet from year to year the expenditure which war necessitated. This "is a salutary and wholesome check, making them feel what they are about, and making them measure the cost of the benefit on which they may calculate".¹ Bastable, in his *Public Finance*, holds that "this concession to the policy of borrowing should not be stretched to include the cost of works or other State action that yields no revenue. Non-economic² expenditure is primarily to be met out of income, and unless it can be so dealt with ought not to be incurred. National culture, education, the promotion of social progress are all most desirable ; but their

¹ Hansard, p. 376, March 6, 1854.

² I.e. non-productive.

promotion is not so urgently required as to need the use of borrowing by the public powers. It is indeed true that much of State expenditure may be regarded as indirectly productive, and as likely to add to the national income in the future. A loan for the purpose of extending education, or for improving the housing of the workers, though it does not directly provide the interest needed, may yet so increase the income of the community as to make the tax receipts greater, without any increase either in rates or in rigour of collection. Regarded in the abstract, such a proceeding seems defensible; the real objections to it arise from the difficulty of application. The results of expenditure of the kind are hard to trace or measure, and any statement respecting them must rest in a great degree on conjecture. The cost of the loan is definite and precise, and it constitutes a real burden on the resources of the society. Prudence seems accordingly to suggest that borrowing should hardly ever be adopted except for strictly economic expenditure, and then only when the extension of the State domain is clearly advisable.”¹

4. A view similar to this was expressed by the Hon. Sir Basil Blackett,² Finance Minister of India, in his Budget speech, 1923. Speaking in the Indian Legislative Assembly, he said: “We have spent many crores on unproductive purposes, the expenditure on which is classed as capital expenditure. New Delhi³ is the most obvious example. I can see no justification other than sheer necessity for not treating this expenditure as chargeable against revenue, and in any case it ought to be repaid out of revenue at an early date.”⁴ In regard to those States which, refusing to balance their income and expenditure, meet deficits from loans, *e.g.* by expenditure from capital in place of expenditure from revenue, he said: “The individual who lives beyond his income year by year does not escape the penalty, and the same is true of a State. The individual who makes this mistake quickly finds himself compelled to consent to a ruthless cutting down of his expenditure or is driven either to sell or to mortgage a part or the whole of his possessions; or, in the worst

¹ Bastable, *Public Finance*, Book V. ch. v. pp. 670-71.

² Sir Basil Blackett, K.C.B., was Controller of Finance, H.M. Treasury, from 1919 to 1922.

³ Originally estimated to cost £4,000,000. In January 1923 the cost was estimated at Rs.1292 lakhs or £8,614,000.

⁴ *Legislative Assembly Debates*, vol. iii. No. 48, p. 2931.

event, to cheat his creditors. A State is in the same position, but the position is frequently obscured by the fact that the State's creditors are in another capacity the citizens of the State, and its taxpayers. And the State which is driven to cheat its creditors does not always realise what it is doing, although its unsound methods are adopted at the expense not only of the wealth and happiness of its own citizens, but also at considerable risk to social order within its borders." A striking example of the truth of this is Germany, which entered the War with an undeveloped system of taxation, having no large annual revenue from taxation. To meet the enormous cost of the War it relied on loans followed by more loans—a suicidal policy financially. Its persistent and heavy borrowings crippled it, and in 1918 the Revolution took place. Too large borrowings affect the ordinary revenue detrimentally, as an unusual proportion of expenditure is required for debt charges. Still further borrowings are made on disadvantageous terms, and insolvency usually follows.

5. All things considered, it may be said that expenditure chargeable to capital is justified in three instances :

- (i.) for permanent productive investments, *i.e.* for the construction of public works such as irrigation works, railways, etc., and also certain works, civil and quasi-military, which give the prospect of a return on capital over a long series of years ;
- (ii.) in an extraordinary emergency like war ; and
- (iii.) in cases of temporary necessity—(a) casual deficits and (b) wasting assets.

6. Firstly with regard to (i.)—capital expenditure for productive purposes. It is unfair to ask the taxpayers of a single year to bear the entire burden of works which will be a source of profit as well as a benefit to the community over a period of years. In most cases the taxpayers would be unable to meet such a demand. To take one instance : the Sukkur Barrage, the largest irrigation scheme in the world, is estimated to cost Rs.18 crores (£12 millions), and on completion will increase the area under cultivation by 3,300,000 acres. The value of the gross produce of Sind, which in a bad year such as 1921 was worth Rs.26·4 crores (£17·6 millions) and in a fair year such as 1922 Rs.37·4 crores (£25 millions), will be less liable to fluctuation, and when the scheme is complete will be on present prices

no less than Rs.87 crores (£58 millions) per annum. As the State develops its activities the amount of capital expenditure will increase. In India, for example, capital expenditure is all too small. The habit of investment is not widespread as it is in France and in England, owing to the blight of illiteracy that prevails up and down the countryside. It must not be assumed that the contraction of debt means the destruction of capital. So far from being thrown away, it may increase the revenue.

Loans for capital expenditure should be fixed within such limits as will make the payment of interest and the gradual repayment of the principal over a stated period, *i.e.* by the operation of a sinking fund, a certainty. In regard to local authorities, such as municipalities, it is often advisable to limit even arbitrarily the amount of the debt which these authorities may legally contract, *e.g.* a fixed percentage of the assessed valuation of its real estate. It is sound policy to make provision for the gradual repayment of the loan from an early period of its currency. The payments may be spread over even 80 years,¹ according to the nature of the undertaking and the length of time for which its utility is to endure. If the original form of the capital is an asset which is liable to become antiquated in, say, 40 years, the sinking fund payments should be such as to extinguish the debt within that period. It is not essential that sinking fund payments should take place from the first year of the loan. Indeed it is often convenient to postpone these payments until the concern for which the capital was raised is in working order. The construction of the work should be pushed on rapidly, as small grants are to be condemned not only from the engineering but from the financial point of view. Commercial methods should be adopted from the outset.

Where a State's resources are limited and credit easily shaken by even slight over-borrowing (and many instances leap to one's memory), the sinking fund, even in productive capital expenditure, increases confidence and the marketability of the loan. Insurance companies, for example, when looking for sources of investment, always prefer loans of a reasonable terminable nature with adequate sinking funds. Many countries, therefore, apply

¹ The annual sinking fund for the Dominion of Canada extinguishes the gross debt of the Dominion in 75 years. For productive expenditure in India 80 years would be suitable.

a given sum annually from taxation or savings to the reduction of debt, and the interest on these annual sums accumulate for the same object. The Chinese Imperial Government 5 per cent Gold Loan of 1896 for £16 millions has a sinking fund which will extinguish the loan in thirty-six years. The Chinese Government 5 per cent Reorganisation Gold Loan of 1913 for £25 millions is for 47 years and is redeemable by the action of a sinking fund by 37 annual drawings commencing in 1924. Experience teaches that it is of little use to devote the surplus of good years to the reduction of debt. There is always a strong temptation to reduce taxation or to spend the surplus in directions other than in the reduction of debt. An overflowing treasury is almost certain to produce unwise legislation in this respect, especially in countries comparatively young in democracy.

7. Capital expenditure is in the second place permissible in the extraordinary emergencies demanding large outlays, e.g. wars or earthquakes involving excessive destruction, such as the Japanese earthquake of 1923. We have already indicated that public expenditure chargeable to capital does not mean the destruction of capital, but even profitable investment. McCulloch goes so far as to hold that the provision of funds from capital for war may bring a considerable net gain to a country. "No sacrifices", he says, "can be too great that are required to preserve national security and independence, and a loan expended on armies and fleets employed for such a purpose is quite as well and profitably employed as if it has been laid out on agriculture or in promoting manufactures or trade." In war the fate of present and future generations is in the balance and part of the burden rightly falls on posterity. Moreover, the expenditure has to be undertaken promptly, and the money is required immediately at almost any cost.

With his usual shrewdness, the author of the *Wealth of Nations* remarks that the borrowing of capital for war expenditure has the disadvantage that it removes an adequate check on the undertaking and continuance of war. Taxation, on the other hand, raises criticisms in the legislature which affects those responsible for the policy of war. Between 4th August 1914 and 31st March 1920 the German Reich issued loans to the enormous sum of over 222,000,000,000 marks, and, as we have already seen, the War

expenditure had to be met from loans contracted in an ever-rising market. In Great Britain, however, the maximum of taxation was imposed, and resort to loans was accompanied by a change in the revenue system.¹ Expenditure from capital is indispensable to sound war finance, and lightens, if intelligently and discreetly used, the burden of war.

The financing of the Great War has taught us that a war cannot be financed either by loans or by taxes. At the outbreak of war more has to be raised by loans than by taxes, but as the war proceeds the proportion of expenditure from revenue must increase. In other words, the machinery of taxation should run at a greater speed. The aim of the statesman is to increase taxation to a point that the taxable capacity of the country can bear. This should be sufficiently high to provide for all extra debt charges and at the same time to make adequate provision for the repayment of debt within a reasonable period without prejudicing industry or curtailing war production. There is no definite time within which the war debts should be repaid, because the date of the next war cannot be foreseen. The golden rule is to pay off the debt as fast as the resources of the country will allow. If a provision for a sinking fund will enable the country to float its loans at a lower rate of interest this is an undoubted advantage, but a sinking fund for dead-weight debt sometimes results in a good deal of statistical juggling, as the history of English sinking funds proves. A sinking fund, if provided, would probably be for half the period fixed for productive expenditure, say forty years. In the case of a great nation which raised its revenue from taxation to the highest possible limit to defray a large part of the extraordinary expenditure, a simple paying off and wiping out of its own debt is a sufficiently safe plan.

8. The third case where recourse to loans may be desirable is that of temporary necessity. This class must not be held to include much. It is indeed intended to be anything but comprehensive, and to be severely limited in its meaning. "Temporary necessity" is not a haven of rest for the financier anxious

¹ The expenditure chargeable against revenue was as follows—the revenue is given in brackets—(in millions sterling): Year ended 31st March—1914, (pre-War), £197 (£198); 1915, £1133 (£227); 1916, £1560 (£337); 1917, £2198 (£573); 1918, £2696 (£707); 1919, £2579 (£889); 1920, £1666 (£1340); 1921, £1195 (£1428); 1922, £1079 (£1125); 1923, £910 (£911).

to raise loans. It embraces practically only two instances of temporary necessity. In the first place it includes the covering of a *casual* deficit of a small amount (but not a series of recurrent deficits).¹ Careful budgeting means the equating of revenue with expenditure.² Sometimes it happens that revenue may not come up to expectation on account of some unforeseen event. As Governments do not keep a large reserve in their Finance Departments,³ it may be necessary to throw this deficit on to the following year. The deficit of a bad year is thus carried by the surplus of a good year, and a revision of the taxation system and retrenchment are avoided. Public credit will not be injured, but rather the reverse, by the knowledge that Government has been alive to the situation and taken time by the forelock. Another instance is the construction of very urgent works which happen to be not productive but a wasting asset. If, for example, Government decides that it must construct houses for its police in an area where housing accommodation is difficult to obtain, it may be compelled to undertake out of "sheer necessity" the construction of tenements from capital in the same way that a manufacturer may do so for his mill hands. The millowner would ordinarily build the houses or tenements from capital and set aside a suitable sum annually as depreciation over, say, forty years. If he had a good year or series of years larger amounts might be set aside and the buildings written down considerably. Similarly Government would set aside a certain amount annually to a sinking fund—the longer the period of the currency or running off of the loan, the less the annual payments to the sinking fund. It might be possible to pay part of the expenses for construction from revenue and part from capital. The amount absolutely necessary for Government to grant as house allowance to enable these officers to live in the area in which they have to

¹ Cf. the Indian Finance member's remarks in his Budget speech quoted above: "When I came to look into the finances of India for the last few years, I was tempted to wonder whether it was not rather a rake's progress. For five years in succession, India has had a deficit. The accumulated total of these deficits amounts to no less than 100 crores, and this in spite of the fact that in the last two Budgets additional taxation has been imposed estimated to bring in about 28 crores during the year 1922-23."

² A budgeted surplus tends to encourage extravagance, while moderate deficits tend to the exercise of economy.

³ The Finance Department of the Government of Bombay, with a revenue in 1922-23 of Rs.1400 lakhs, kept only Rs.20 lakhs or 1·4 per cent as a special reserve for contingencies.

live might be capitalised, say over forty years, the life of the buildings, and this amount paid from revenue. At all events, in the case of wasting or melting assets the debt charge should be sufficient to pay interest and to wipe out the principal in forty or any stated number of years.

One school of financial opinion maintains that all unproductive expenditure is primarily to be met out of revenue or income, and it ought not to be incurred from capital, however strong a sinking fund may be established. A strict adherence to this theory would in the long run mean the curtailment of civil and other works till the revenue position of a country improves. The opposite school holds that in certain conditions loans to provide for non-revenue-yielding expenditure may be necessary. These conditions are (1) the benefit conferred on posterity by the work which will last for a period, often a long period of years. It is held to be undesirable that the present generation should pay for what does not benefit it exclusively ; (2) the heavy pressure of existing taxation, especially if there is a large degree of inequality in distribution and the consequent fear that the imposition of any additional burden may involve an unbearable strain.

The first view is strictly in harmony with the best of financial traditions and is certainly sound. It is the one to which all soundly financed Governments should look despite the exigencies of post-War finance, because countries are impoverished and it is unwise to sink savings in uses which yield a return after a long interval. A recent Cambridge writer puts it aptly thus : " As a community we cannot save so much, we ought not to save so much, when we are impoverished as when we are prosperous. It is vital to appreciate this truth, because, as we shall see, by no means all the saving of the world is done by individuals. There are many forms of ' collective saving ', which take place in actual fact ; still more which we are often urged to undertake. And it is of practical importance to realise that the very considerations, which call most urgently for individual thrift, forbid a great indulgence in such projects. A time of national poverty is not a time when it is suitable for the State to embark on large schemes of capital development : we require our resources for more immediate ends."¹ This view should certainly not be lightly discarded unless the conditions postulated by the second school

¹ Henderson, *Supply and Demand* (Cambridge University Press), p. 129.

of financial thought are most clearly and unmistakably established and unless the urgency of the unproductive work to be undertaken is proved beyond all shadow of doubt. This is indeed difficult in times of impoverishment. In all circumstances it is desirable that sinking funds should be so adjusted that unproductive loans are extinguished much sooner than productive loans, at least within forty years.

CONCLUSIONS

9. The principles governing public expenditure chargeable to capital may be summarised thus :

(1) Except in three cases where recourse to loans is necessary or desirable, public expenditure should be met from income, if necessary by increased taxation.

(2) Even if the expenditure is abnormal and extends for more than a twelvemonth, taxation should be increased to meet this charge as far as practicable.

(3) The three instances where loans are necessary or desirable are (a) permanently productive investments ; (b) an extraordinary emergency, such as war ; and (c) certain cases of temporary necessity, *e.g.* a *casual* deficit.

(4) In permanently productive investments the repayment of the capital spread over several years is better than sudden heavy taxation, and commercial methods should be adopted from the beginning of the undertaking.

(5) In an extraordinary emergency, such as war, enhanced taxation would neither be sufficiently productive nor immediate. The dangers of the system arise from the apparent lightness of the burden of loans as compared with that of taxation. The ideal is to impose the maximum of taxation from the outset, *i.e.* to get the maximum in the form of taxes from the unwilling as well as loans from the willing. (See (2) above.)

(6) In cases of temporary necessity public credit will not be affected by, for example, provision against a casual deficit of a bad year being carried on to the following year. Constant changes in the taxation system are avoided. On the rarest of occasions political reasons may be so important that it may be considered politic to avoid fresh taxation and to incur the expenditure from capital.

(7) Sinking funds for productive and unproductive capital expenditure increase confidence, especially where resources are limited and credit easily shaken by over-borrowing. It is therefore necessary to make gradual provision for the repayment of a loan from an early period of its currency. This is preferable, as experience shows, to devoting the surpluses of good years to debt reduction.

(8) The successful operation of a sinking fund depends on (*a*) the regular investment of a sum obtained from taxation or from savings, and (*b*) the accumulation of all the interest upon such sums. As a general rule the period for productive loans may be fixed at as much as eighty years and for unproductive loans at forty years or less according to the life of the wasting asset.

CHAPTER XII

SOME GENERAL PROBLEMS OF EXPENDITURE

ORDINARY AND EXTRAORDINARY EXPENDITURE

1. WE have already referred to the difficulty of distinguishing between ordinary and extraordinary expenditure.¹ "Every Government should," according to the Brussels Financial Conference, 1920, "as the first social and financial reform on which all others depend, restrict its ordinary recurrent expenditure, including the service of the debt, to such an amount as can be covered by its ordinary revenue ; . . . abandon all unproductive extraordinary expenditure ; restrict even productive extraordinary expenditure to the lowest amount. If the above principles are accepted and applied, loans will not be required for recurrent ordinary expenditure ; borrowing for that purpose must cease. In a number of countries, however, although the ordinary charges can be met from revenue, heavy extraordinary expenditure must at the present time be undertaken on capital account. This applies more especially in the case of those countries devastated during the War, whose reconstruction charges cannot possibly be met from ordinary receipts. The restoration of the devastated areas is of capital importance for the re-establishment of normal economic conditions, and loans for this purpose are not only unavoidable but justifiable.² But in view of the shortage of capital it will be difficult to secure the sums required even for this purpose, and only the most urgent schemes should be pressed forward immediately."

¹ P. 53.

² French savings have provided most of the capital required for the restoration of the French devastated areas. (One of the problems of Reparations is to shift this capital liability of the French Government to the shoulders of the German Government with the least disturbance.)

The expressions "ordinary" or "normal" and "extraordinary" or "abnormal" are for all practical purposes sufficiently well understood in the science of finance, and it was in view of this that the Brussels International Conference (which comprised leading financial experts of the thirty-nine countries represented) passed the resolution already quoted. The terms ordinary and extraordinary are self-explanatory. Extraordinary expenditure includes exceptional expenditure of a more or less non-recurring nature. Some countries, such as Canada and Germany, under extraordinary expenditure include all capital expenditure. The "Dominion" expenditures of Canada, for example, under "ordinary"—debt charges, subsidies to provinces, cost of collecting revenue, defence, pensions, civil government, public works and some miscellaneous items; while under "extraordinary"—capital expenditures, railway subsidies, War loans—expenses and discounts, and War charges. Thus extraordinary expenditure in Canada includes recurring expenditure in that it includes year after year a provision for capital expenditures, and from 1915 War expenditure over and above the provision under "ordinary expenditure—militia and defence". In Indian public expenditure Famine Insurance is an ordinary item year after year. In a time of very exceptional famine (*quod avertat Deus*) it may be necessary to budget for a sum over and above the amounts assigned for famine insurance. This would then be extraordinary expenditure. At the outbreak of the Great War, War expenditure in English finance was extraordinary, but when Mr. McKenna was Chancellor of the Exchequer in 1916 he insisted that the Budget should include all normal expenditure and the War debt charge: a high standard of finance. In the English Budget itself there is, of course, no distinction between ordinary and extraordinary.

In the sanctioning of estimates legislatures rightly insist on proposals laid before them for sanction being grouped into two classes—recurring or recurrent and non-recurring or non-recurrent. The former have to be carefully watched since these have a permanent effect on the State's expenditure. There are also supplementary estimates which come up for sanction between the presentation of one Budget and that of its successor. Supplementary estimates may be either items which were not ready at

the preparation of the Budget or items which were of a completely unforeseen nature. Orthodox finance of the last century disliked such estimates as being of the nature of "sloppy finance". "I look" (said Gladstone, when Chancellor of the Exchequer in 1862, to the Public Accounts Committee) "with great jealousy upon Supplementary Estimates. I think that Supplementary Estimates are very plausible in principle, but that in practice nothing would so much tend to defeat the efficacy of Parliamentary control as the easy resort to Supplementary Estimates. It is absolutely necessary, in my opinion, to the efficacy of Parliamentary control that the House of Commons should have the money transactions of the year presented to it in one mass and in one account."¹

2. In the Brussels International Conference Resolution productive and unproductive expenditures are contrasted. The same distinction is often seen in the distinction between productive debt and ordinary or dead-weight debt. Expenditure which brings in a fair return on the capital invested is said to be productive. Thus irrigation works which pay the current or normal rate of interest are productive. Expenditure on a town-hall or park would ordinarily be unproductive, while expenditure on waterworks productive. As in the case of the individual, expenditure, in essence unproductive, may be indirectly productive and the whole community may increase its production or wealth in the long run by such expenditure. In reality all public expenditure should be of this nature, but this should not blind one to the distinction already made. In regard to productive expenditure Government naturally regards it, to some degree at least, as a question of investment. Take, for example, the Sukkur barrage in Sind, the largest irrigation project in the world. In unproductive expenditure such as protective irrigation works and the construction of New Delhi other issues are introduced. General financial considerations must obviously govern the limit of expenditure of this class, except perhaps where a nation's honour and security are threatened.

PUBLIC EXPENDITURE AND NATIONAL INCOME

3. The question is sometimes asked whether there is any relation between public expenditure and national income. Is

¹ Cf. *National Economy*, Higgs (Macmillan, 1917), p. 23.

there a percentage of public expenditure to the gross annual income of society which will provide a basis for judging the expenditure of a Government? Is there a percentage beyond which a Government should not go, unless it wishes to dislocate industry and indeed the economic organisation of society and to compel its citizens to live a worried and down-trodden existence? In the second half of the eighteenth century Justi, who published in 1766 his *System des Finanzwesens* (the first systematic work, perhaps, on Finance), answered the question in the affirmative; 16 per cent was an average, and 25 per cent excessive. No writer to-day, after the experience of the Great War and its financing, would regard these figures as applicable to present conditions, and a much larger percentage would be taken as moderate.

The following table summarises the details of public expenditure and national income in different countries:

PERCENTAGE OF ORDINARY EXPENDITURE OF CENTRAL AND
PROVINCIAL GOVERNMENTS TO NATIONAL INCOME

Country.	Pre-War Year.	Post-War Year.
United Kingdom	8.8	20.2
India	6.4	8.3
Canada	11.6	16.9
Australia	26.0	33.9
United States of America	3.3	5.9
France	12.6	15.6
Japan	13.1	14.7
Italy	10.5	11.1

Note.—Purely Local Government expenditure is excluded as accurate data are not available in all cases.

The very simplicity of the above table hides the fundamental difficulties of the problem. Even in the same country comparisons are, at different periods, difficult on account of the fall in the purchasing power of money. This may be corrected by dividing the expenditure and national income by the index number of wholesale prices, as is done in Table X. Appendix. Other reasons are the development of State activities or the acquisition of new territories. Social legislation (*e.g.* State management of certain undertakings, State aid to schools and hospitals, and old

age pensions) makes it difficult to compare present-day expenditure as a percentage of national income with that of earlier times. The acquisition of new territory or the cession of it renders comparisons also difficult. Again there is always the danger of expenditure being counted twice, as, for example, when the State gives grants-in-aid to local authorities. The preparation, therefore, of detailed table No. V. Appendix was unusually difficult.

Then again in making comparisons between different countries it is necessary to see that the figures which are compared are really comparable; central and provincial expenditure should be included in all cases, and, if possible, also local expenditure. Official statistics of actual local expenditure country by country are very difficult to obtain. In 1922 and 1923 about half the total public expenditure in the United States is estimated to have been incurred by the Federal authorities, 15 per cent by States, and 35 per cent by local authorities. In comparing this percentage with that of, say, Canada or Australia, the scope of the statistics should be the same. There are other factors, such as differences in the size of income, accumulated wealth, the distribution of wealth, and economic progress, that do not always strike one as one's eye runs down the percentage figures in the table. Differences in the amount of income have to be remembered, since 10 per cent in India would not be the same as 10 per cent in the United States, any more than 10 per cent means the same to a man earning Rs.100 a month and another earning Rs.10,000 a month. Another factor is the accumulated wealth of a country which is somewhat used to no purpose or for a wrong purpose. In one of the largest native States in India there is considerable wealth, the accumulation of centuries. The ruler's *private* wealth (*i.e.* apart from the State treasure) in coin and bullion is over Rs.10 crores, or about £7 millions. The jewels, valued on the accession of the ruler, were worth over Rs.200 crores, or about £133 millions. These could be drawn on in cases of emergency. The distribution of wealth is also of some importance. Countries are so diverse in their economic conditions and their tax systems so different that the tax *per capita* and *per* "contributable", as the French would say, vary considerably. Economic progress in one country may be slower than in another. Quesnay, the Physiocrat, rightly said that poor peasants make a poor kingdom, and a poor kingdom a poor king. The object of the outlay has to be

considered. Expensive programmes of education, public health, irrigation, and street construction may, for example, be incurred in one country while another country may be spending on what is not enriching citizens to anything like the same degree. The extension, then, of administrative action is important, as in India, where the Bombay Government has extended administrative action further than other provinces. In times of grave national danger, as in the late War, high expenditures in proportion to national income would be justifiable.

The general conclusion is that something in the neighbourhood of 20 per cent of the national income, other things being equal, is spent by public authorities in normal times. In grave emergencies, as in the War, this is even doubled for a time. Increasing expenditure presupposes elasticity of revenue, and this is always possible so long as national income increases faster than national expenditure. To this we shall return in discussing taxable capacity,¹ and in estimating the real burden of taxation² and national income. Care has to be taken to see that enough is left for national consumption, and that industry is not crippled for want of funds. Twenty per cent will not, from what has been said, affect rich and poor countries alike. When the limits of taxable capacity are reached, recourse in urgent cases to capital expenditure makes it possible to distribute the burden over a long period.³

¹ Chapter XV.

² Chapter XXIX.

³ See Chapter XXIX. on the burden of taxation.

BOOK III
PUBLIC REVENUE OR INCOME

CHAPTER XIII

THE CHARACTERISTICS AND CLASSIFICATION OF PUBLIC REVENUE OR INCOME

THE CHARACTERISTICS OF A GOOD REVENUE SYSTEM

1. WHAT are the characteristics of a good revenue system when viewed as a whole? It should in the first place possess the characteristics of good taxes which make up the system—the characteristics of equality, certainty, convenience of payment, and economy in collection.¹ If a revenue system requires a large number of officials for the collection of taxes,² if evasion and vexation are common, and if trade is hampered, then the system cannot be said to be satisfactory.

A good revenue system should be truly a system and not a collection of isolated acts, based on haphazard methods. It should rest securely on a basis of comprehensive statistics. It should be possible to budget with fair accuracy for a steady calculable return, and when new changes are made, greatly increased expenditure on collection and new machinery should not be necessary. Each new fiscal act should be capable of being interpreted as part of a connected scheme possessing a definite place in the financial structure. There should be, moreover, as far as possible no conflict of tax jurisdiction among administrations.

A good revenue system should also possess the mark of elasticity. This is of special importance in times of emergency and elasticity, therefore, should always be an important characteristic of a Central or Federal Government which is responsible for defence. Gladstone in his first Budget speech³ spoke of the

¹ For the canons of taxation see Chapter XIV. p. 121.

² "Every tax ought so to be contrived as both to take out and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the State" (*Wealth of Nations*, Bk. V. ii.).

³ 18th April 1853.

income tax as "an engine of gigantic power for national purposes", an elastic tax which in a time of vital struggle makes it possible to raise additional revenue to meet war expenditures. A revenue system ought to be capable of increasing automatically with the wealth of its citizens and with the consequent demands for greater expenditure on the part of Government. Under the Indian Constitution of 1919 a provincial Government, like that of Bombay, has land revenue and excise as its two main heads, but these are not adequately expansible. They depend on uncertain factors, *e.g.* land revenue depends on the monsoon, and excise on the prosperity of the working classes. It is therefore not possible for the provincial Government to finance comprehensive schemes of universal primary education and of public health. The Finance Member said in the Bombay Legislative Council, while introducing the Budget, that "the House will no doubt remember the fluctuating character of our revenue. Our Land Revenue only two years ago, owing to an adverse season, fell to 431 lakhs, while this year we are collecting 582; our Excise has varied 50 lakhs in a year; our Stamps have fallen off 40 lakhs from the estimates."¹ "We cannot rest content until our revenue is more broadly based; until we have secured resources which are not all liable to diminution simultaneously, and, so far as possible, solid resources which will not be subject to fluctuation at the very time when the strain on the public exchequer increases most severely."² An amount of land revenue per acre, fixed for thirty years, is far less advantageous than a proportionate amount of the annual rental or capital value.

Lastly, there are the characteristics of sufficiency and productivity. The revenue should be equal to the demands made on it. As a rule revenue is ordinarily raised from a small number of productive taxes rather than from a large number of comparatively unproductive taxes. In Great Britain, however, before the War there was a tendency to over-concentrate on a few taxes, with the result that indirect taxation might have been less felt if the taxes had been scattered over a large number of commodities. Productivity is an important quality of a good revenue system, and covers, as has often been said, a multitude of faults.

¹ *Bombay Legislative Council Debates*, vol. viii. Part I. p. 41 (Government Central Press, Bombay).

² *Ibid.* vol. vii. Part II. p. 535 (Government Central Press).

THE CLASSIFICATION OF PUBLIC REVENUE OR INCOME

2. "The revenue which must defray", writes the author of *The Wealth of Nations*,¹ "not only the expense of defending the society and of supporting the dignity of the chief magistrate, but all the other necessary expenses of government, for which the constitution of the State has not provided any particular revenue, may be drawn either, first, from some fund which peculiarly belongs to the sovereign or commonwealth, and which is independent of the revenue of the people; or, secondly, from the revenue of the people. The funds or sources of revenue which may peculiarly belong to the sovereign or commonwealth must consist either in stock or in land. . . . Public stock and public lands, therefore, the two sources of revenue which may peculiarly belong to the sovereign or commonwealth, being both improper and insufficient funds for defraying the necessary expense of any great and civilised State; it remains that this expense must, the greater part of it, be defrayed by taxes of one kind or another; the people contributing a part of their own private revenue in order to make up a public revenue to the sovereign or commonwealth." Adam Smith tells us, in short, that the sovereign in some cases had a fund or source of revenue of his own, as in Holland and Venice a bank, and in Hamburg a wine cellar and an apothecary's shop. He is of opinion that the Government of England would be well advised not to undertake banking, but the Post Office is within its powers. It does not manage the Crown lands well, and could not undertake the management of all the lands in the State. Whence, then, is its revenue to come? Obviously from taxation.

The classification of public revenue or income on the lines of Adam Smith is hardly suitable to-day as it is too antiquated for twentieth century finance. His main divisions, two in number, (a) property belonging to the sovereign, and (b) revenue derived from the people, would hardly be sufficiently comprehensive. Since Adam Smith's time local self-government has grown apace, the activities of public authorities have increased, and social services have developed to a degree never dreamt of half a century ago. The property of the sovereign is now, as it was not when Adam Smith wrote, an almost insignificant source of the State's

¹ Book V. chapter ii.

annual income. The main source is taxation. For present purposes it will be sufficient to group other sources as follows : public undertakings ; public lands ; special assessments (especially in the United States) ; loans and miscellaneous sources, such as gifts, and fines. Two-thirds of the revenue of India to-day are from taxation, and a shade over 20 per cent from Government undertakings, as will be seen from the following table :

PERCENTAGE OF TOTAL ANNUAL REVENUE OF INDIA
(CENTRAL AND PROVINCIAL)

	1871-72.	1901-2.	1911-12.	1921-22.
Tax revenue	89.4	67.6	63.1	66.7
Non-tax revenue :				
Government or public undertakings	5.0	27.5	31.5	22.9
Others	5.6	4.9	5.4	10.4
	100	100	100	100

It should be noted that loans have not been regarded as a source of revenue in the above table, as borrowing to meet current expenditure, as in the late War, simply postpones the time when the required revenue must be obtained from some other source. In addition to this postponement is the disadvantage that interest has to be paid on the loans, and thus this resort to loans is justified only in exceptional circumstances. Loans belong, therefore, to an extraordinary source of revenue, and are not usually included in the revenue or income of public authorities. If, however, loans were included the pre-War year's income and that of 1921-22 for the Governments of Great Britain and India (central and provincial) would have been as follows :

	India.		Great Britain.	
	1913-14.	1921-22.	1913-14.	1921-22.
Taxation	41.5	48.5	65.2	74.7
Government undertakings .	23.5	16.6	12.3	4.9
Loans	31.4	27.4	20.8	1.9
Others	3.6	7.5	1.7	18.5
	100	100	100	100

The revenue of Great Britain is given in Table XII. Appendix, and of India in Table XIII. Appendix, where the figures are set out in detail.

3. Taxes are compulsory contributions to public authorities to meet the general expenses of government which have been incurred for the public good and without reference to special benefits. From the time we enter the world until we leave it, whether we are rich or poor, we depend at every stage on the machinery of government especially for the protection of life and property. Taxes, therefore, are paid for the participation in such common benefits and not for any special advantages enjoyed by the taxpayer.

Fees are payments primarily in the public interest for special services which people must accept whether willingly or not. They confer a special advantage on the fee-payers, although this special advantage (as in the case of registration fees, *e.g.* for documents or marriage licences) is secondary to the primary motive of regulation in the public interest. In this respect fees differ from prices. They differ also from taxes in that they are payments for special benefits enjoyed by the payer, while taxes are for general benefits. Fees are undoubtedly co-ordinate with taxes, and are conveniently grouped as below under the main head tax revenue just as prices are grouped under non-tax revenue. It is, indeed, sometimes difficult to draw a clear line of distinction between taxes and fees. When, for example, is a licence a fee and not a tax? Where the licensee gets a special benefit for the privilege it is in Seligman's view a fee, but where the licence charge is so high as to bring in a *net* revenue to the public authority it is a tax.¹ Licence fees may indeed be regarded on the whole as taxes. They are ordinarily far more than the mere cost of service, and the positive service rendered is very often absent. Special assessments are best known in the United States, and may with great advantage be generally introduced in India and other countries. These are sometimes classified with fees. Special assessments, unlike fees, are levied, especially by municipalities, once for all to meet some extraordinary expenditure, such as a special improvement to property undertaken in the public interest. These are levied on property in proportion to the benefit that results. Seligman in his able treat-

¹ Cf. Seligman, *Essays on Taxation*, p. 411.

ment of this subject points out the following characteristics of special assessments : “ (1) there is the element of special purpose ; (2) the special benefit is measurable ; (3) these assessments are not progressive but proportional to the benefit received ; (4) they are for specific local improvements ; and (5) they provide for the capital account to increase, as it were, the permanent plant of the community ”.

The revenue from public undertakings is sometimes spoken of as a price. Prices are in this sense charges paid by the consumers of the commodities sold by the public authority, and these special commodities or services people are not compelled to accept unless they choose.

In regard to loans it is advantageous to restrict the borrowing powers of public authorities, such as provincial or State Governments and local authorities. This may be done, for example, by limiting the amount to be borrowed to a percentage of the value of taxable or rateable property, or by prescribing the rules for sinking funds and for objects for which loans may be incurred. In 1894, in the Constitution of the New York State, the indebtedness of any city within the State was limited to 10 per cent of the assessed valuation of its real property. This has been criticised on the ground that no distinction was made between productive and non-productive debt, and therefore productive municipal improvements were unnecessarily postponed. Exception, however, was made of revenue bonds issued in anticipation of receipts from taxes and of water bonds. These water bonds were to be included in the municipality's debt when the issue of bonds for any other purpose was proposed.

Under “ miscellaneous ”, fines and gifts are the best examples. Fines are imposed, not for revenue, but mainly to deter from certain acts, and in this respect are different from taxes. Taussig, then, is not quite correct when he says that the characteristic of a tax is “ the absence of a direct *quid pro quo* between the taxpayer and the public authority ”. This would equally apply to fines which are not taxes. Gifts to Government are not, unfortunately, very large or frequent. Examples are “ conscience money ” in the British fiscal system, donations to the “ conscience fund ” in the United States (which are in both cases usually moneys which should have been paid in income tax), and gifts in the form of gilt-edged securities, as when certain citizens

handed over War loan for cancellation on patriotic grounds during the War. It is a matter for comment that few realise in giving gifts to Government¹ that they are contributing to the agency whose first aim is the advance of the general welfare.

There has been a tendency in modern financial literature to lay unnecessarily great stress on the classification of revenue. The chief aim of classification is the light which such classification throws on the nature of public income. The object in view is a practical one. It prevents loose thinking and much confusion of thought, and at the same time is of assistance in dealing with matters of fact. No system possesses clearly cut lines of demarcation throughout; no system is absolutely good or absolutely bad. It is hard to find a system with all the virtues the financier would desire, and it may be said that there is no "correct" or "perfect" classification mainly from historical peculiarities in the countries compared.

4. German writers of the nineteenth century from Rau onwards devoted considerable space to this aspect of public revenue. In the present century, American writers, pre-eminently Seligman,² and Italians, like Einaudi, have done good work in this direction. Bastable divides public revenue into two classes: (1) "that obtained by the State in its various functions as a great corporation or 'juristic person', operating under the ordinary conditions that govern individuals or private companies", and (2) "that taken from the revenues of the society by the power of the sovereign".³ This classification does not appear to be comprehensive, and fees, gifts, fines, special assessments, etc., are difficult to classify under this classification. Is not much of economic revenue (group 1) collected "by the power of the sovereign"? It has, however, advantages, as it is a practical division of the two well-known classes of income. In Bastable's own words, "These are broadly contrasted and must form the basis of any division: it is to their discussion that by much the largest part of any work on the subject must be devoted, and

¹ This is in contrast to gifts for schools, hospitals, etc. Even here in some countries, as in India, public effort in this direction with rare exceptions is conspicuously absent.

² "The Classification of Public Revenues," chapter xiv. of *Essays in Taxation*, 9th edition (Macmillan & Co.).

³ *Public Finance*, Book II. chapter i. p. 158.

it is by the way in which he handles them that a writer will be judged".¹

5. Adams has three main groups with sub-groups:²—I. Direct revenue: (a) public domains; (b) public industries; (c) gratuities, gifts, or treasure trove; (d) confiscations and indemnities. II. Derivative revenue: (a) taxes; (b) fees, assessments, fines, and penalties; and III. Anticipatory revenue: (a) the sale of bonds or other forms of commercial credit, and (b) Treasury notes. Thus one group deals with revenue from mainly public lands and public industries. The second group has for its scope taxation, and the third public credit. It is doubtful whether direct and derivative revenues do not overlap. It is questionable, too, whether in public income income from loans should be regarded as (ordinary) income or revenue. Loans are more in the nature of "receipts"³ than revenue, and are in reality a charge on revenue. They may be regarded, as already noted, as constituting an extraordinary rather than an ordinary source of revenue.

6. A third classification which has received considerable attention in recent years is that of Seligman, which is based on the relative importance of the public and private purposes in the service rendered by the public authority. He classifies all public revenues into three classes: I. Gratuitous, such as gifts; II. Contractual, such as prices. This includes public property and industry; III. Compulsory, (a) eminent domain—expropriation; (b) penal power—fines and penalties; (c) taxing power, (1) fees, (2) special assessments, and (3) taxes. Thus Seligman's classification depends upon the relative importance of special to common interest. "In the one case the individual is the chief or only factor; in the other case the individual sinks his own importance in the common welfare of the community, and whatever benefits he derives come to him only incidentally as a result of his membership in the community. At one extreme lie prices, which depend upon the relation of the government to some particular industry or individual; at the other extreme lie taxes, which depend upon the relation of the government to all industries or individuals; midway between these extremes lie fees."⁴

¹ *Public Finance*, Book II. chapter i. p. 165.

² *The Science of Finance*, p. 219 ff.

³ Whatever is received into the Treasury may be termed receipts, but revenue is receipts which need not be repaid in the same form.

⁴ *Essays in Taxation* (9th edition), p. 431.

THE IDEAL CLASSIFICATION

7. From what has been said, it will be seen that there is one main division, in fact the main division, of public revenue or income common to the majority of classifications. It may sometimes be the case that this division is not called by the same term, and in one or two unimportant subheads these may not be identical. Adam Smith speaks of the source "from the revenue of the people". Contemporary writers speak of it as "that taken from the revenues of the society by the power of the sovereign" (Bastable), or "derivative revenue" (Adams). Seligman speaks of compulsory revenues with the sub-group taxing power, viz. taxes, special assessments, and fees.

All things considered, it will be best to term this first main division "tax revenue", and to include under "tax revenue" both special assessments and fees. A caveat in regard to fees is necessary. Fees are used in the sense above, *i.e.* of revenue derived from *monopoly* enterprise such as registration, but not fees which do not possess the attributes defined on p. 113. Thus fees from education and other social services would not be classified under "tax revenue". Modern financial literature has accepted the nomenclature of "fees" in the technical sense, *i.e.* where there is a special and measurable benefit accruing to the individual together with a predominant public object.

Taxes are conveniently grouped into two main classes—direct taxes and indirect taxes. Direct taxes are sometimes defined as those paid once for all by the person from whom they are collected and not passed on to others, while indirect taxes are paid by the producer or importer and passed on to the consumer. John Stuart Mill defined a direct tax as "demanded from the very persons who it is intended or desired should pay it" and an indirect tax as one "demanded from one person in the expectation and intention that he shall indemnify himself at the expense of another".¹ The intention referred to is doubtless that of the legislator, but the intention of the legislator does not always square with actual fact. Thus in the British income tax under Schedule A the tax on the landlord's income from the ownership of land and buildings is collected under statute from the occupier of the land or buildings, although it is legally imposed on the

¹ *Principles*, Book V. chap. iii. para. 1.

landlord. The occupier deducts the tax from the rental due to the landlord, any contract not to deduct it being legally void. According to Mill's definition this tax would be indirect, but it is really direct. The fact that the distinction between direct and indirect taxes is so closely related to the difficult question of incidence has led some writers to overlook the difficulty of defining precisely direct and indirect taxation. Sidgwick, indeed, realised this when he wrote "we can only partially succeed in making the burden of 'direct' or 'indirect' taxes fall where we desire; the burden is liable to be transferred to other persons when it is intended to remain where it is first imposed; and, on the other hand, when it is transferred, the process of transference is liable to be tardy and incomplete".¹

The intention of the legislator is hardly a sufficient reason for the distinction between direct and indirect taxes. Moreover, the example quoted above from the British Income tax shows that what might at first blush be taken as an indirect tax is in reality a direct tax. It is necessary, therefore, to explore the subject a little further. Hadley² believes that the distinction between direct and indirect taxation should be based on the immediate and not on the ultimate incidence. According to him, taxes which are not shifted at all and those which are shifted legally (for example by the occupier to the landlord) are direct, while those which are shifted quickly through commercial competition among consumers are indirect.³ This distinction is of interest, but it hardly conforms to the meaning in financial practice. Bastable too is hardly correct when he writes that "practical financiers . . . regard those taxes as direct which are levied on permanent and recurring occasions, while charges on occasional and particular events are placed under the category of indirect taxation".⁴ Practical financiers the world over regard death duties as direct taxation, but if this latter definition were accepted these inheritance taxes would be indirect. Other writers have attempted without success to define direct taxes as taxes on persons and indirect taxes as taxes on things, but such a definition is no more

¹ *Principles of Political Economy*, Bk. III. chap. viii. § 8.

² *Economics*, pp. 459-461 (Putnam's, London).

³ Hadley refers to shifting *slowly* through industrial competition by the withdrawal of capital as ultimate incidence, and therefore not entering into the distinction between direct and indirect taxation.

⁴ *Public Finance*, p. 291.

useful than a distinction between personal and specific taxes or between subjective and objective taxes. Paul Leroy-Beaulieu, like Mill, looks at the intention of the legislator, and groups all taxes as direct when they are intended to be a charge on the taxpayer immediately, but he adds proportionately to the fortune or revenue of the taxpayer. This distinction would place a poll tax which was not graduated and such consumption taxes as are imposed immediately on the consumer, *e.g.* the British inhabited house duty, and taxes on motor cars and male servants under indirect taxation.¹

All things considered, it is preferable to define direct taxes as those levied immediately on the property and income of persons and those which are paid by the consumers to the State direct. Thus income and property taxes, death duties, poll taxes, and consumption taxes paid to the State direct, would form the group of direct taxes, while all other taxes would be grouped as indirect, *i.e.* those which reach the income and property of persons through their acts and enjoyments and also through their consumption of commodities under customs and excise. In addition to customs and excise duties, taxes on business, turnover, amusements, and betting would be grouped as indirect taxes. This distinction does not look to the intention of the legislator as to who bears the tax, but it rests on whether the tax is immediately paid from income or property and by the consumer direct. If so, it is a direct tax. All other taxes are indirect.

In addition to direct and indirect taxes, special assessments and fees, should be included tributes, capital levies, and indemnities. Although it is desirable to keep "revenue" and "capital" accounts separate, it is not out of place to regard a capital levy or an indemnity as a tax. Fines and penalties are sometimes included under tax-revenue, but they are more correctly classified under non-tax revenue. These are, however, of little importance as a source of revenue when compared with taxes, fees, and prices.

The second main division is non-tax revenue, and this includes (1) the revenue from government or public undertakings, *i.e.* prices. This would include railways, irrigation, other public

¹ By "direct" taxes on the Continent is meant in practice those for which the taxpayers' names are entered on a register, maintained by central and local authorities. This register gives the basis of assessment and the amount due. Thus the division between direct and indirect rests on the mode of collection, and not with the incidence of the tax.

works, posts, telegraphs, telephones, mints, stationery, and printing, forests, etc. ; (2) the revenue from social services, *e.g.* education and hospital fees or receipts ; (3) revenue from loans or debt services—the State is sometimes a lender of funds ; and (4) miscellaneous. This last head would not be of importance but would in most cases include a few special heads which could not be conveniently grouped under heads (1), (2), and (3). In India, military receipts, exchange, and receipts in aid of superannuation would be included under this miscellaneous grouping.

The following tables show for India and Great Britain the classification in detail.

PERCENTAGE DISTRIBUTION OF THE GROSS REVENUE OF THE GOVERNMENT OF INDIA (CENTRAL AND PROVINCIAL)

Heads of Revenue.	1871-72. 50 years ago.	1891-92. 30 years ago.	1911-12. 10 years ago.	1913-14. Pre-War.	1921-22.
<i>A. Tax Revenue :</i>					
Land revenue . . .	41.0	26.9	25.1	25.1	17.2
Other direct taxes . .	3.1	6.6	3.4	3.2	12.8
Total direct taxes . .	44.1	33.5	28.5	28.3	30.0
Indirect taxes . . .	45.3	31.6	34.6	32.1	36.7
Total tax revenue . .	89.4	65.1	63.1	60.4	66.7
<i>B. Non-tax revenue :</i>					
Government or public undertakings . . .	5.0	30.3	31.5	34.3	22.9
Social services . . .	..	0.3	0.3	0.4	0.4
Other sources . . .	5.6	4.3	5.1	4.9	10.0
Total non-tax revenue .	10.6	34.9	36.9	39.6	33.3
Grand Total . . .	100.0	100.0	100.0	100.0	100.0

PERCENTAGE DISTRIBUTION OF REVENUE IN GREAT BRITAIN

Heads of Revenue.	1901-2.	1911-12.	1913-14.	1921-22.
Income tax	24.3	24.2	23.8	35.5
Other direct taxes . . .	11.7	15.6	15.5	10.1
Total direct taxes . . .	36.0	39.8	39.3	45.6
Total indirect taxes . .	49.2	44.0	42.9	30.6
Total tax revenue . . .	85.2	83.8	82.2	76.2
Posts and telegraphs and telephones	12.5	13.9	15.5	5.0
Miscellaneous	2.3	2.3	2.3	18.8
Total non-tax revenue . .	14.8	16.2	17.8	23.8
Total revenue	100.0	100.0	100.0	100.0

CHAPTER XIV

THE CANONS OF TAXATION

1. IN a previous chapter where the characteristics of a good revenue system were dealt with,¹ a reference was made to the canons, or to use Adam Smith's expression, the maxims of taxation, which are an indispensable part of any exposition on public finance. We shall now refer to these in greater detail. In spite of the unfair and destructive criticisms of Cohn and Walker,² these Smithian canons have rightly been regarded as classic. Modern writers, notably Garnier, Roscher, and Ricca-Salerno, not to mention Wagner, have attempted to lay down precepts or rules regarding the characteristics of a good tax system. No genius, however, has succeeded in condensing the principles into such clear and simple canons as has Adam Smith. His acute and capacious mind gave an entirely new turn to former inquiries, and his successors have not, to any material degree, improved on these principles or succeeded in displacing them from the position which they hold in the science of finance. It is true some have altered the relative importance of these canons, and others have attempted (not always successfully) to introduce new fundamental principles. One writer,³ for example, analyses taxes from three points of view: (1) that of the taxpayer; (2) that of the State; and (3) that of society as an economic or

¹ Chapter XIII. p. 109.

² Cf. F. A. Walker's remarks in his *Political Economy* (Macmillan), §§ 587-589: "A vast deal of importance has been assigned by English economists to these maxims. They have been quoted over and over again as if they contained truths of great moment; yet if one examines them, he finds them, at the best, trivial; while the first and most famous cannot be subjected to the slightest test without going all to pieces" (§ 587).

³ Sir Josiah Stamp, *The Fundamental Principles of Taxation in the Light of Modern Developments* (The Newmarch Lectures for 1919), Macmillan, 1921.

producing unit. Prof. Cannan, however, with reason shows that these are not fundamental principles but merely another way of saying that equity, productiveness, and economy (economy being used in its wider sense of general social advantage) are the basic principles of taxation.¹

Some have sought to trace the maxims to the two Physiocrats—Moreau de Beaumont and Turgot. There was, it is true, in Adam Smith's library the *Mémoires* by Moreau de Beaumont.² In a letter to Sir John Sinclair, Adam Smith confessed that "he (Smith) had frequent occasion to consult the book himself, both in the course of his private studies and in the business of his present employment (as Commissioner of Customs), and is therefore not very willing to let it go out of Edinburgh. The book was never properly published; but there were a few more copies printed than were necessary for the Commission for whose use it was compiled. One of these I obtained by the particular favour of Mr. Turgot, the late Controller-General of the Finances. I have heard but of three other copies in Great Britain. . . . If any accident should happen to my book, the loss is perfectly irreparable." Cunningham, in his *Growth of English Industry and Commerce*, holds that "Adam Smith's celebrated maxims about taxation are improved in form, but in substance they are found in the Avertissement to the splendid *Mémoires* which were compiled and printed for the French Government in 1768".³ Similarly Leon Say and Thorold Rogers⁴ believed Turgot's *Formation and Distribution of Wealth* had a considerable effect on the author of

¹ *Economic Journal*, vol. xxxi., 1921, p. 350.

² Cf. Bonar's *Catalogue of the Library of Adam Smith* (Macmillan, 1894), p. 9. *Mémoires concernant les impositions et droits en Europe* (par Moreau de Beaumont), Paris (vols. i.-iv. 1768-69; vol. v. 1789). In Bk. V. ch. ii. pt. i. of *The Wealth of Nations*, Adam Smith thus describes the book: "This work was completed by the order of the court for the use of a Commission employed for some years past in considering the proper means for reforming the finances of France. The account of the French taxes, which takes up three volumes in quarto, may be regarded as perfectly authentic. That of those of other European nations was compiled from such information as the French ministers at the different courts could procure. It is much shorter and probably not quite so exact as that of the French taxes."

³ Vol. ii. p. 437.

⁴ Cf. Rae, *Life of Adam Smith* (Macmillan), p. 203. "Questions of literary obligation are often difficult to settle. Two contemporary thinkers, dealing with the same subject under the same general influences and tendencies of the time, may think nearly alike even without any manner of personal communication."

The Wealth of Nations. The maxims of the Physiocrats¹ were far from perfect from the undue importance given in their system to the rent of land as the only "net product" and, therefore, the only source of taxation. To-day Adam Smith's canons continue to be regarded as almost an essential part of the study of finance, and they have had a considerable effect on practical financiers, as, for example, on Gladstone in England,² and on James Wilson, the first Finance Minister of India.³ They are extremely simple maxims, and in this lay their author's stroke of genius. In short, they were, in the phraseology of *The Wealth of Nations*, "intelligible to common understandings".

I. THE CANON OF EQUALITY OR EQUITY

2. "The subjects", says Adam Smith, "of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state. The expense of government to the individuals of a great nation, is like the expense of management to the joint tenants of a great estate, who are all obliged to contribute in proportion to their respective interests in the estate. In the observation or neglect of this maxim consists what is called the equality or inequality of taxation. Every tax, it must be observed once for all, which falls finally upon one only of the three sorts of revenue above mentioned, is necessarily unequal, in so far as it does not affect the other two. In the following examination of different taxes I shall seldom take much further notice of this sort of inequality, but shall, in most cases, confine my observations to that inequality which is occasioned by a particular tax falling unequally even upon that particular sort of private revenue which is affected by it."

II. THE CANON OF CERTAINTY

3. "The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner

¹ *Œuvres de M. Turgot, Ministre d'État* (Paris, A. Belin, 1811 (9 vols.)).

² *Vide* Gladstone's budgets, especially that of 1853 (*Gladstone's Speeches*, Methuen & Co.).

³ Finance Minister 1859-60. *Vide* Bagehot (his son-in-law), in *Life of Waller Bagehot*, vol. x. p. 347 (Longmans, Green & Co., 1918).

of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person. Where it is otherwise, every person subject to the tax is put, more or less, in the power of the tax-gatherer, who can either aggravate the tax upon any obnoxious contributor, or extort, by the terror of such aggravation, some present or perquisite to himself. The uncertainty of taxation encourages the insolence and favours the corruption of an order of men who are naturally unpopular, even where they are neither insolent nor corrupt. The certainty of what each individual ought to pay is, in taxation, a matter of so great importance, that a very considerable degree of inequality, it appears, I believe, from the experience of all nations, is not near so great an evil as a very small degree of uncertainty."

III. CONVENIENCE OF TIME OF PAYMENT

4. "Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it. A tax upon the rent of land or of houses, payable at the same term at which such rents are usually paid, is levied at the time when it is most likely to be convenient for the contributor to pay; or, when he is most likely to have wherewithal to pay. Taxes upon such consumable goods as are articles of luxury, are all finally paid by the consumer, and generally in a manner that is very convenient for him. He pays them by little and little, as he has occasion to buy the goods. As he is at liberty, too, either to buy, or not to buy, as he pleases, it must be his own fault if he ever suffers any considerable inconveniency from such taxes."

IV. ECONOMY IN COLLECTION

5. "Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the state. A tax may either take out or keep out of the pockets of the people a great deal more than it brings into the public treasury, in the four following ways. First, the levying of it may require a great number of officers, whose salaries may eat up the greater part of the produce of the tax, and whose perquisites may impose

another additional tax upon the people. Secondly, it may obstruct the industry of the people, and discourage them from applying to certain branches of business which might give maintenance and employment to great multitudes. While it obliges the people to pay, it may thus diminish, or perhaps destroy, some of the funds which might enable them more easily to do so. Thirdly, by the forfeitures and other penalties which those unfortunate individuals incur who attempt unsuccessfully to evade the tax, it may frequently ruin them, and thereby put an end to the benefit which the community might have received from the employment of their capitals. An injudicious tax offers a great temptation to smuggling. But the penalties of smuggling must rise in proportion to the temptation. The law, contrary to all the ordinary principles of justice, first creates the temptation, and then punishes those who yield to it; and it commonly enhances the punishment, too, in proportion to the very circumstance which ought certainly to alleviate it, the temptation to commit the crime. Fourthly, by subjecting the people to the frequent visits and the odious examination of the tax-gatherers, it may expose them to much unnecessary trouble, vexation, and oppression; and though vexation is not, strictly speaking, expense, it is certainly equivalent to the expense at which every man would be willing to redeem himself from it. It is in some one or other of these four different ways that taxes are frequently so much more burdensome to the people than they are beneficial to the sovereign. The evident justice and utility of the foregoing maxims have recommended them more or less to the attention of all nations. All nations have endeavoured, to the best of their judgement, to render their taxes as equal as they could contrive; as certain, as convenient to the contributor, both in the time and in the mode of payment, and in proportion to the revenue which they brought to the prince, as little burdensome to the people.”¹

These celebrated canons are quoted because they are the foundation of the principles governing the imposition of taxes, and are quoted *in extenso* because when quoted partially they omit much that Adam Smith considered to be of real importance.

If a tax combines all these things it is plainly a good tax. The first canon contains an important rule of taxation and deals

• ¹ *The Wealth of Nations*, Book V. chapter ii. part ii.

with the elements of several distinct theories on equitable taxation. To this we shall return in dealing with the distribution of taxation. It will suffice here to mention that the right of the sovereign power is to impose taxation, and it is the duty of the subjects to contribute. We have already referred to this compulsory character of the contribution, and it was the determination to insist on this right which led the British Government to insist on the threepence per pound duty on tea, and also the retention of the stamp duties, both of which lost the American colonies. The expression "under the protection of the state" was regarded by Walker¹ as unnecessary and inconsistent, but to those who know *The Wealth of Nations* well it is probable that Smith was thinking of greater issues, *e.g.* the taxation of property held in different countries. At the end of *The Wealth of Nations* Smith deals with a project of Empire representation and taxation,² and elsewhere he refers to the movement of capital from one country to another in order to escape taxation. His outlook was imperial and international as well as national.

The second canon, the canon of certainty, has received great prominence by some American writers. So much so that certainty is regarded as the most important of the canons. Thus Hadley somewhat dogmatically holds that "in the light of experience in modern industrial communities there can scarcely be any doubt as to the proper choice. Certainty is the fundamentally important object, without which all attempts at equality prove illusory. With an uncertain tax no systematic improvement can be hoped for. With a certain tax many evils which exist at the outset tend to diminish as time goes on. Uncertainty

¹ *Political Economy*, § 588: "What mean those last words, 'under the protection of the State'? They are either irrelevant, or else they mean that the protection enjoyed affords the measure of the duty to contribute. But the doctrine that the members of the community ought to contribute in proportion to the benefits they derive from the protection of the State, or according as the services performed in their behalf cost less or cost more to the State, involves the grossest practical absurdities. Those who derive the greatest benefit from the protection of the state are the poor and the weak—women and children and the aged; the infirm, the ignorant, the indigent."

² "If the project cannot be completed, it ought to be given up. If any of the Provinces of the British Empire cannot be made to contribute towards the support of the whole Empire, it is surely time that Great Britain should free herself from the expense of defending these provinces in time of war, and of supporting any part of their civil or military establishments in time of peace, and endeavour to accommodate her future views and designs to the real mediocrity of her circumstances" (Book V. chapter iii. finis).•

may result either from failure to discover the objects which should be taxed ; or from doubt as to their value ; or from the possibility of collusion between the assessor and the person who should pay the tax by which consent is given to an unduly low valuation.”¹ Seligman in discussing the importance of precision in assessments is also of opinion that “ ever since the days of Adam Smith, the demand for certainty has been one of the cardinal rules in taxation. Adam Smith borrowed his rule from one of the French writers. The arbitrariness of the French system of taxation in the eighteenth century had assumed such proportions as already to pass beyond belief, and it is no wonder that the would-be fiscal reformers raised a loud note of protest against the utter lack of certainty and precision in the French system.”² An old tax is sometimes said to be no tax because it makes no disturbance of the *status quo*. There is, indeed, a good deal of truth underlying this. The canon of certainty, like the canon of convenience and the canon of economy, is a rule applicable in the long run to taxes as a whole. These Smithian canons or maxims are financial, although some have other characteristics, *e.g.* there is a distinct ethical bearing in the first, and in the second a constitutional issue.

OTHER CANONS

6. Some writers have attempted to enlarge on these canons by emphasising³ that a tax should fall on revenue and not on capital, and that it should not interfere with the minimum of subsistence nor result in the transfer of capital on account of the taxation imposed. These rules, however, are not so fundamental as those of Adam Smith, although of some importance from a practical point of view. Bastable⁴ lays down, in order of importance, that in the first place taxation should be productive. A considerable amount of the reputation which Gladstone won as a Finance Minister was due to his realisation of this point. “ The very object for which the revenue system exists is to provide for the maintenance of the State, and therefore the Minister in charge of the finances naturally estimates the merits

¹ *Economics*, Hadley (Putnam), p. 451.

² *Essays in Taxation*, Seligman (Macmillan & Co., 9th edition), p. 390.

³ *E.g.* Sismondi.

⁴ *Public Finance*, Bastable (Macmillan & Co.), p. 417.

of a tax by the amount of its yield." Next to productiveness, Bastable believes the most important principle is that taxation should be economical, *i.e.* inexpensive in collection and at the same time retarding the growth of industry in the country as little as possible. Both productivity and economy, although separated by this writer, have a much closer connection than is at first glance discernible. To-day productivity and economy would probably be regarded as one by the practical financier. In addition to these two rules, Bastable lays down four other rules, *viz.* : (1) taxation should be justly distributed ; (2) the tax system should be elastic ; (3) taxation should be certain ; and (4) taxation should be convenient.

A CONFLICT OF PRINCIPLES

7. When there is a conflict between these principles it is usual to adopt the most important canon in preference to the less important. Productiveness is more important than equality and convenience. Similarly a large amount of economy should outweigh a small amount of equality and *vice versa*. After all, since successful administration of the State is the primary object, it is not unreasonable that equity and convenience should yield to productiveness. In short, in cases where conflict arises, choose the more important. " After all the proper subjects of taxation ", says Adam Smith, " have been exhausted, if the exigencies of the State still continue to require new taxes, they must be imposed upon improper ones. The taxes upon the necessities of life, therefore, may be no impeachment of the wisdom of that republic, which, in order to acquire and to maintain its independency, has, in spite of its great frugality, been involved in such expensive wars as have obliged it to contract great debts. The singular countries of Holland, and Zealand, besides, require a considerable expense even to preserve their existence, or to prevent their being swallowed up by the sea, which must have contributed to increase considerably the load of taxes in those two provinces ";¹ and again, " It ought to be remembered, that when the wisest Government has exhausted all the proper subjects of taxation, it must, in cases of urgent necessity, have recourse to improper ones. The wise republic of Holland has upon some occasions been obliged

¹ *The Wealth of Nations*, chap. ii. pt. ii. art. iv. (p. 390, Cannan's edition).

to have recourse to taxes as inconvenient as the greater part of those of Spain.”¹ A finance minister finds himself confronted with demands for revenue on the part of spending departments and on the other with opposition from those whom he wishes to tax. A tax which brings in a large net revenue without protest from taxpayers with political influence he regards as a good tax. Much indirect taxation rests on this and it is a tempting one to follow since it is often the path of least resistance. He plucks, in short, the feathers of the goose with as little squealing as possible. In the *Laws of Manu* the king is counselled to tax little by little “as the leech, the calf, and the bee take their food”. In critical times he may take as high a proportion as one-fourth, “if he protects his subjects to the best of his ability”, but he should not “cut his own root, nor the root of others, by excessive greed”.

¹ Book V. chapter iii.

CHAPTER XV

THE MEASUREMENT OF TAXABLE CAPACITY WITH SPECIAL REFERENCE TO GREAT BRITAIN AND INDIA

1. In a previous chapter¹ the percentage of gross national income spent by public authorities was discussed. Gross income was taken since it was, on the whole, the fairest and best possible test of what is after all an approximation. In normal times it was shown that 20 per cent is spent from all sources by public authorities, and in abnormal times (as in the War and post-Armistice period) the figure is as high as 40 per cent. The State can take large appropriations for a short period from its subjects for temporary objects without *permanent* injury. On the other hand, a State which appropriates only a small proportion of the gross income has much larger resources in times of necessity. When taxes are very moderate, the revenue appropriated by the State is small, and individuals, especially in a rich country, may spend far less wisely than if the State imposed taxation for social services such as education. It is sometimes an unwise policy to allow money to fructify in the pockets of the people unnecessarily, but the reactions on production have to be considered by the State in extending taxation beyond a certain limit. Education and compulsion in taxation can do much.

THE CONCEPT OF TAXABLE CAPACITY

2. In the present chapter we propose to examine the conception of taxable capacity as applied to a country. In recent years this has become a matter of unusual interest. The necessity to have larger revenues to balance budgets, to repay war debts, not

¹ *Vide* p. 102.

to speak of reparations, has made this one of great practical importance. It is a question that has taxed the brains of the most expert financiers. The value of full and accurate statistics of a country's production and its consumption, as shown in a census of production and in carefully collected family budgets, and of statistics of income tax can scarcely be exaggerated. It is always wise and useful for a Government to know even roughly the limit that the country can contribute by way of taxation both in ordinary and in extraordinary circumstances. The lack of information on taxable capacity has reminded not a few Governments of the parable of the foolish virgins who went forth to meet the bridegroom without oil in their lamps.

THE LIMIT OF SQUEEZABILITY

3. The term taxable capacity is regarded as an unattractive cryptogram. This, however, is unfortunate, because the conception is obviously one of financial importance. It was considered by that well-known Scotch official of the Board of Trade, Sir Robert Giffen¹ (1837-1910), and more recently by Sir Josiah Stamp, formerly of the British Board of Revenue.² It is essential to remember the distinction between national capital and national income. The capital of a community is an amount of wealth at a particular moment, while the income is an amount of wealth obtained during a unit of time, usually a year. Capital is always measured as a quantity and income is measured as a rate. One is a static conception quite independent of time, while the other is a dynamic conception involving the time element. As every one knows, the citizens of a country are always contributing to a "heap" of goods and services and withdrawing what is required for subsistence. The taxable capacity of any country is not an absolute amount, and one can only suggest symptoms which show that the taxable limit is being approached or the reverse. Precise limits are not capable of being measured with accuracy, for reasons which will shortly be explained. Taxable capacity may be defined as the maximum amount which the citizens of a country can contribute towards the expenses of public authorities without

¹ Minutes of Evidence on the Financial Relations between Great Britain and Ireland (C. 8008), 1895.

² *Wealth and Taxable Capacity* (2nd edition, 1923), King & Co.; *British Incomes and Property* (2nd edition, 1921), King & Co.

having to undergo an unbearable strain, or, as Sir Josiah Stamp in a singularly attractive way describes it, "without having a really unhappy and downtrodden existence and without dislocating the economic organisation too much".¹ Public authorities are like the mother in the Sanskrit verse—"The girl covets beauty, the mother riches, the father knowledge, the relatives good family, other people sumptuous marriage feasts". These authorities have to earn their living, and it is desirable to ascertain what this maximum limit at any time approximately is. Briefly, taxable capacity is the limit of squeezability. It is the total surplus of production over the minimum of consumption required to produce that volume of production, the standard of living remaining intact. The minimum of consumption includes a minimum of subsistence for the people and an amount for the replacement of and an addition to capital for the purpose of industrial and commercial expansion. Some writers exclude additions to capital on the ground that in times of emergency these additions need not be made, but some additions are essential if the standard of living is to be maintained intact in a growing population. By "minimum of subsistence" we mean necessities for efficiency. This minimum will differ in different countries. It is quite conceivable that a man may be better able to provide himself with the necessities of life, such as a fair supply of nourishing food and housing, than a man in another country on identically the same income. If a *per capita* expenditure is taken for any country it may be too large for some of the population and too small for others, but like army clothing it does for everybody although it fits no one in particular. The fact that part of an income, which is seemingly at a minimum, is used to purchase other things than necessities is conclusive evidence of there being more than necessities of existence. As Maggie Mucklebackit replies to the Antiquary of Sir Walter Scott when the Antiquary expressed the hope that the distilleries would not work again: "Ay ay, it's easy for your honour and the likes of you gentlefolks, to say sae, that hae stouth and routh and fire and fending and meat and claith and sit dry and canny by the fireside—but an ye wanted fire and meat and dry claise and were deeing o' cauld, and had a sair heart whilk is warst ava', wi' just tippence in your pouch, wadna ye be glad to buy a dram wi't to be eilding and

¹ *Wealth and Taxable Capacity*, p. 134.

claise and a supper and heart's ease into the bargain till the morn's morning".

4. Thus the surplus or difference between the total quantity of production and the minimum of consumption necessitated by the volume of that production is not and cannot be an absolutely fixed figure. It depends on (1) the number of inhabitants in the State ; (2) the distribution of wealth in the State ; (3) the method by which taxes are raised ; (4) the purpose of taxation ; (5) the psychology of the taxpayers. In regard to (1)—the number of citizens—it is obvious that a population of 20 millions with an aggregate production of £200,000,000 has a different taxable capacity than if the population were 100 millions. In the former case there would be more than in the latter to spare to the State for public purposes. In regard to (2)—the distribution of the surplus—the taxable capacity will not be the same if incomes are more or less equal, while in others they are graduated. If there are 10,000 persons at a level of £100,000 and 1 person with £1,000,000, there would obviously be a larger taxable capacity than if the same aggregate income were equally divided among all persons. Thirdly, capacity also depends on the way in which the taxes are raised. A well-thought-out mixture of taxation produces a larger sum than if any one line of taxation were followed. It is, for example, necessary to stop increasing taxation in one direction when it is felt to be exceedingly onerous, and to launch out in another direction, such as by heavier death duties. A tax on the necessities of life or a tax on savings is not the same as a tax on drink. Again the surplus depends on the object or objects in view. To what purpose is taxation to be applied ? Taxation devoted to the repayment of internal debt is very different from taxation devoted to the payment of external debt or for such unproductive purposes as armaments. Interest on internal debt is spent within the country. The payment of interest on external debt reduces the net income of the debtor or paying country by the transfer of part of its income abroad, to pay the interest, *i.e.* a certain amount of the country's produce is exported without any return and not, as in the case of payment of interest on internal debt, transferred to others who consume it in the country. The former is the case with war debts, such as the debt payments to America at the present time and reparation payments when made. Similarly with productive loans

advanced to countries for their industrial development, as India, Australia, Canada, and the Argentine. The debt may increase the national income of the country by a sum much larger than the debt payments abroad, and payments for public servants and others temporarily resident in the country may also increase the national income to a far greater extent than what they send as remittances to pay for the education of children, etc., in say England. To make this payment for interest charges and to provide for the gradual repayment of the capital, the country which has to pay the debt raises revenue by taxation, borrowing, or inflation. Whichever method is adopted the real incomes of her citizens *qua* citizens are reduced, *ceteris paribus*, and where, as a result of this, production is decreased, it means further impoverishment. There is no direct compensation for the taxation. If the money is applied in paying interest on internal debt or in repaying internal debt, there will, in either case, especially in the latter, be a greater taxable capacity, because the taxes are returned to the citizens, *i.e.* money is raised within the country and paid out to holders of Government stock who are also within the country. For example, the present public debt of England, excluding debt to America, is held to the extent of nearly seven-eighths by "nationals". Taxation, moreover, may be applied to the construction of irrigation works, railways, and similar undertakings, which increase the productive powers of the country. The psychology of the people taxed has much to do with the extent of taxable capacity. People are often willing to bear heavier taxation on patriotic or sentimental grounds, or, as stated above, to pay more in indirect taxation distributed over every day of a year than a direct tax levied in lump once a year. In India a town will thrive with octroi taking much more than a house tax which will drive population away. Great Britain, at the beginning of the nineteenth century when fighting Napoleon, was spending one-third of the aggregate of individual incomes, that is, as £90,000,000 to £270,000,000. France after the Franco-German war and at the present time is bearing for patriotic reasons a heavy amount of taxation. Sentiment plays a considerable part in taxation as in politics. Oppression may raise men into heroes or sink them into slaves. Heavy taxation may make some men industrious, enterprising, and wealthy, while others become indolent, dispirited, and impoverished. .

SUMMARY

5. To sum up, the taxable capacity of a country is ascertained by a reference to the total surplus of production over the minimum of consumption required to produce that volume of production. It is not an absolute amount, but depends, among other things, on the number of inhabitants, the distribution of wealth and of taxation, as well as on the purpose for which the Government imposes taxation. It depends on whether the revenue from taxation is spent inside or outside the country. The limit of taxable capacity is said to be reached when on account of the heaviness of taxation consumption is curtailed and industry crippled, and when a further outlay on the cost of collection and an increased rate of taxation do not bring in an additional return. It is sometimes said that this limit is reached when taxpayers in some countries are compelled to sell their securities to pay taxation or to borrow from the banks. The consumption of a people does not increase in the same proportion as a rise in national income, and the taxable capacity or surplus, therefore, becomes a larger margin. Similarly if the national income decreases, the national consumption does not correspondingly diminish, and it thus leaves a smaller taxable surplus.

THE MEASUREMENT OF TAXABLE CAPACITY

6. How is taxable capacity to be measured? Its statistical determination is, from what has been said, obviously a difficult matter. The best way to estimate taxable capacity is to follow one of two methods: (a) the personal or aggregate income method—the basis of this is an analysis of individual incomes based on income tax returns supplemented by statistics of death duties and other property taxes; or (b) the production method, which is to add up the various parts of the aggregate produce. The best example of the former method is Great Britain, where there is in existence a very efficient system of income tax derived from (1) interest on investments; (2) income from land and buildings; (3) profits from farming; (4) income from employment; (5) profits from professions; and (6) profits from trade. There is also the British Census of Production Report, 1907,¹ taken under

¹ Cd. 7320.

the Census of Production Act of 1906. Of the second method India may be taken as an example. In India the income tax does not apply to agriculture, the main industry; and only in recent years, especially since the formation of a Board of Central Revenue in the Government of India in 1923, has the administration of the tax been on lines similar to those in Great Britain. The income tax returns, therefore, are incomplete, and recourse is necessary to the second or production method as a test of the taxable capacity of its inhabitants, whatever the source of their wealth may be.

FIRST METHOD

7. The Right Honourable Reginald McKenna, Chairman of the Midland Bank, in an address to the National Union of Manufacturers in June 1920, was of opinion that there was grave over-taxation, and that a budget of £1,000,000,000 was as much as the country could afford. Even this figure he did not believe was sufficient to leave a margin for the increase of capital necessary for the recuperation and development of industry. Stamp, in his *Wealth and Taxable Capacity*,¹ challenges this and points out that all the issues were not included in the statistics. Interest and repayment of debt were, for example, treated in the same way as if the money had been spent on armaments. He believed that the taxable capacity of Great Britain had not been reached. "As such attempts are actually being made by others", he writes, "I have endeavoured to indicate some of the principles and precautions which must be observed if they are to have any approach to correctness of degree, and if the results are to be inaccurate only to the extent of errors in the statistical assumptions."² The heaviness or otherwise of taxation at different periods, however, cannot be determined without due regard to the level of prices on those dates. The burden of taxation is felt heavily, especially in a time of falling prices.

In the following table the taxable capacity for the pre-War year (1913-14) and for 1921-22 in regard to the United Kingdom is set out. The provisional estimates for the year 1922-23 have also been added. The 1921-22 figures are based on the assumption that production in that year was 85 per cent of that in 1913-14.

¹ Page 125.

² Preface to the 1923 edition of *Wealth and Taxable Capacity* (King & Co.).

TAXABLE CAPACITY OF THE UNITED KINGDOM (In £ millions)

	Pre-War Year 1913-14. Stamp.*	1921-22. Stamp.	1922-23. G.F.S.
1. Difference between production and minimum consumption	750	960	810
2. Savings for ordinary replacement of and addition to capital	500	150 †	140 †
Taxable capacity (1-2)	250	810	670
3. Actual budget (excluding non-tax revenue)	163	964	729
4. Interest paid on Government loans	15	200	200
5. Redemption of internal debt by Government	10	100	100
Effective taxation 3-(4 plus 5)	138	664	429
Balance	112	146	241

* With certain small additions as No. 5.

† In these abnormal years savings should be considerably less than in normal times.

8. The table shows strikingly the effect of the War. The surplus of taxable capacity over effective taxation was somewhere in the neighbourhood of £112,000,000 in the pre-War year, and £146,000,000 in 1921-22. In the present year, all things considered, the taxable capacity is less, but the difference between the taxable capacity and the effective budget is greater than in its immediate predecessor. This is mainly due to the fact that tax revenue decreased from £964,000,000 in 1921-22 to £729,000,000 in 1922-23. The results may conveniently be summarised as follows :

	Pre-War Year, 1913-14.	1921-22.	1922-23.
Taxable capacity expressed as a percentage of the difference between production and minimum consumption	33	84 *	83 *
Effective budget (tax revenue only) expressed as a percentage of the difference between production and minimum consumption	18	69	53
Balance expressed as a percentage of taxable capacity	45	18	36

* These figures are high as compared with the pre-War year, mainly owing to a considerable reduction in savings in recent years.

The figures for 1922-23 exclude the Irish Free State and are based on the assumption that production was 87 per cent of the pre-War level, as recent statistics tend to show. Interest on debt and repayment of internal debt are deducted from taxation, as these sums are returned to the taxpayers by the Government and do not diminish the surplus.

SECOND METHOD

9. The estimates of the gross income of British India have been very carefully worked out for the years 1921 and 1922. The year 1921 was abnormal, as the monsoon of 1920 was insufficient, but its immediate successor, the year 1922, was, on the contrary, a good year from the agricultural viewpoint. The value of agricultural produce was calculated at as near a point as possible to the source of production. The Indian land revenue system makes it possible in most instances to secure for each year the acreage and outturn of the main crops. In this respect the agricultural statistics are probably, on the whole, unique in the world. Upon these statistics Government's revenue from land depends. After the out-turn of each crop had been obtained, the next step was to value the crops in each province based on the annual average wholesale prices in that province. Prices of some of the produce, such as tea, coffee, fibres other than cotton and jute, were export prices or prices obtained at the auction sales agency. The calculations were long, even tedious, and were divided into two main groups, viz. food and non-food crops. Food crops include food-grains (by far the most important of agricultural produce), sugar, condiments and spices, orchard and garden produce, drugs, and narcotics, and other miscellaneous food-crops. Non-food crops include oilseeds, fibres, dyes, rubber, and miscellaneous crops. As far as possible produce was not counted twice over. Grain and fodder including straw, for example, are consumed by cattle, which in turn produce milk and hides. The value of cattle, sheep, and goats was excluded, but not milk and hides. The estimates are, if anything, underestimates rather than overestimates,¹ and it is to be remembered

¹ It is extremely difficult, owing to the absence of reliable annual statistics, to arrive at the value of cattle. It is not therefore possible to estimate the net annual growth of stock and its value.

(A) AGRICULTURAL INCOME OF BRITISH INDIA, 1920-21

Crop.	Area.	Out-turn.	Value.*	Percentage to Total.
	Acres.	Tons.	Lakhs of Rs.†	
Rice	78,120,270	27,587,340	511,27	29.8
Wheat	20,367,787	5,648,189	110,30	6.4
Barley	6,268,171	2,536,660	30,76	1.8
Jowar	22,690,318	3,543,535	56,32	3.3
Bajri	12,002,023	1,806,312	30,53	1.8
Ragi	4,238,957	1,523,208	19,07	1.1
Maize	6,205,920	2,065,167	28,01	1.6
Gram	9,463,232	2,371,972	38,49	2.3
Other food-grains	27,533,165	4,084,786	74,33	4.3
Total food-grains	186,889,843	51,167,169	899,08	52.4
Sugar-cane	2,540,920	2,433,108	74,26	4.3
Other sugar	164,853	250,576	14,18	0.8
Total sugar	2,705,773	2,683,684	88,44	5.1
Condiments and spices	1,334,101	667,053	22,24	1.3
Fruits and vegetables	5,171,983	..	85,85	5.0
Miscellaneous food	1,104,375	..	21,42	1.3
Tea	660,751	143,938	13,11	0.8
Coffee	95,501	8,611	1,07	0.1
Tobacco	932,482	445,307	21,29	1.2
Opium	123,834	669	65	..
Indian hemp	2,035	454	11	..
Cinchona	6,057	892	9	..
Other drugs	218,182	..	2,09	0.1
Total drugs and narcotics	2,038,842	..	38,41	2.2
Total food-crops	199,244,917	..	155,44	67.3
Cotton	14,114,276	439,777	31,97	1.9
Jute	2,472,938	1,054,922	19,26	1.1
Other fibres	728,815	239,413	10,11	0.6
Total fibres	17,316,029	1,734,112	61,34	3.6
Linseed	1,496,139	185,031	4,26	0.3
Sesamum	3,591,919	351,032	10,69	0.6
Rape and mustard	2,979,484	508,768	11,87	0.7
Cotton seed	14,114,276†	1,026,146	10,70	0.6
Groundnut	2,123,962	1,014,359	28,91	1.7
Other oil seeds	2,178,888	447,531	10,91	0.6
Total oil seeds	26,484,668	3,532,807	77,34	4.5
Indigo	241,461	2,154	2,67	0.2
Other dyes	487,889	..	5,12	0.3
Total dyes	729,350	..	7,79	0.5
Rubber	75,000	2,962	73	..
Miscellaneous non-food	1,089,483	..	5,45	0.3
Straw	133,180,398	58,275,265	79,32	4.6
Fodder	8,108,016	..	34,77	2.0
Milk . . . . .	..	(Mds.) 290,665,151	278,75	16.3
Wool . . . . .	..	551,865	1,24	0.1
Hides . . . . .	..	37,716	6,55	0.4
Forest produce . . . . .	..	..	6,22	0.4
Grand total	238,933,187	..	1714,94	100.0

* The valuation of the produce was done separately for each province, the annual average wholesale prices of commodities in that province being taken. This will be clear from the following table giving the provincial data for 1921-22. Native States are excluded.

Province.	Value. (Rs. Lakhs).	Percentage to total.	Per Capita Value.
			Rs.
United Provinces	832,32	16.8	73.2
Madras	294,99	14.9	69.7
Bengal	281,76	14.2	60.3
Bihar and Orissa	274,67	13.8	80.8
Punjab and Delhi	226,25	11.4	106.9
Bombay and Sind	207,93	10.5	107.8
Burma	142,20	7.2	120.7
Central Provinces and Berar	139,26	7.0	100.1
Assam	60,09	3.0	79.0
Others	23,94	1.2	75.8
Total	1983.41	100.0	80.9

† A lakh (100,000) of Rs. = £6667. A crore equals Rs.100 lakhs = £666,667.

‡ The area for cotton seeds is the same as for cotton and hence this is not included in the grand total of area.

(B) AGRICULTURAL INCOME OF BRITISH INDIA, 1921-22

Crop.	Area.	Out-turn.	Value.*	Percentage to Total.
	Acres.	Tons.	Lakhs of Rs.†	
Rice	79,699,870	32,704,526	576.86	29.1
Wheat	22,403,559	8,288,857	157.93	8.0
Barley	7,356,429	3,154,794	36.60	1.8
Jowar	24,214,263	5,155,769	80.50	4.1
Bajri	15,900,829	2,273,077	39.45	2.0
Ragi	4,211,067	1,593,889	18.97	1.0
Maize	6,334,705	2,456,317	31.63	1.6
Gram	15,054,855	4,457,963	70.66	3.6
Other food-grains	26,615,231	5,405,688	90.23	4.5
Total food-grains	201,790,808	65,550,880	1102.83	55.7
Sugar-cane	2,363,436	2,295,756	64.59	3.3
Other sugar	158,740	241,284	12.82	0.6
Total sugar	2,522,176	2,537,040	77.41	3.9
Condiments and spices	1,412,359	706,182	23.45	1.2
Fruits and vegetables	5,537,462	..	96.87	4.9
Miscellaneous food crops	1,244,970	..	24.15	1.2
Tea	713,379	116,638	15.15	0.8
Coffee	96,611	7,798	90	..
Tobacco	1,050,685	501,754	23.91	1.2
Opium	122,888	664	65	..
Cinchona	6,538	963	7	..
Other drugs	256,818	..	2.47	0.1
Total drugs and narcotics	2,246,919	..	43.15	2.1
Total food-crops	217,754,694	..	1367.86	69.0
Cotton	11,665,395	501,685	35.60	1.8
Jute	1,505,527	709,679	11.31	0.6
Other fibres	697,860	229,248	7.04	0.3
Total fibres	13,868,782	1,440,612	53.95	2.7
Linseed	2,053,858	311,680	5.48	0.3
Sesamum	3,707,066	363,323	8.46	0.4
Rape and mustard	3,721,813	661,265	13.04	0.7
Cotton seed	11,665,395‡	1,170,658	12.49	0.6
Groundnut	2,061,199	1,005,526	26.76	1.3
Other oil seeds	2,652,634	545,685	11.19	0.6
Total oil seeds	25,861,965	4,058,137	77.42	3.9
Indigo	328,829	3,182	3.94	0.2
Other dyes	525,248	..	5.52	0.3
Total dyes	854,077	..	9.46	0.5
Rubber	75,500	1,857	29	..
Miscellaneous non-food	941,853	..	4.71	0.2
Straw	142,218,521	74,428,171	101.30	5.1
Fodder	8,593,880	..	42.97	2.2
Milk . . . . .	..	(Mds.) 290,065,151	310.36	15.6
Wool . . . . .	..	551,865	1.23	0.1
Hides . . . . .	..	59,371	7.46	0.4
Forest produce . . . . .	..	..	0.40	0.3
Grand total	256,285,356	..	1983.41	100.0

* † ‡ See footnotes on previous page.

in all such inquiries there must be elements of uncertainty and possibly of inaccuracy. We are groping in a maze, and we are compelled to draw conclusions, however vulnerable they may be, from such data as are in our possession.

10. It is possible to compare these results with the data previously worked out on similar lines. The first estimate of its

kind was worked out by the late Mr. Dadabhoy Naoroji, who estimated in 1871 that the income of British India was Rs.340 crores (£340,000,000 at the then rate of exchange of 2 shillings), or Rs.20 per head for an average season. This was based on data for the year 1867-68. Mr. Dadabhoy Naoroji estimated the value of agricultural produce on the incomplete data which only were then available at Rs.277 crores. The non-agricultural income, to which we shall shortly refer, was estimated at Rs.63 crores. In the Famine Commission's Report of 1878 statistics of the population and of the produce of agriculture were published. The Commission adopted for the valuation of the produce Rs.50 per ton for food-grains and Rs.30 per acre for all the other crops. These rates were arrived at from the average monthly retail prices of 10 markets in the United Provinces during the 10 years 1869 to 1878. As pointed out by Lord Curzon in his third budget speech on the 27th March 1901, these results were re-examined in 1881 and 1901. For the year 1881 the average *per capita* income was Rs.27, and in the latter case Rs.30. The figure for 1911 was quoted in the Council of State on 23rd February 1921. These estimates include not merely agricultural production but agricultural and non-agricultural.

THE AGGREGATE AND *Per Capita* INCOME OF BRITISH INDIA IN 1922
AS COMPARED WITH PREVIOUS YEARS

Year.	Population (British India).	Agricultural Income.	Non-agri- cultural Income.	Total Income.	<i>Per capita</i> Income.
	Millions.	Rs. crores.	Rs. crores.	Rs. crores.	Rs.
1871 (50 years ago) .	170	277	63	340	20
1881 (40 years ago) .	196·4	354·5	175	529·5	27
1901 (20 years ago) .	223·5	453·3	217	670·3	30
1911 * (10 years ago)	242·7	1412	530	1942	80
1921 *	247·0	1715	883	2598	107
1922 *	247·0	1983	883	2866	116

* The valuation of agricultural produce for the years 1911, 1921, and 1922 is on a more scientific and careful basis than those for the preceding years, as (1) wholesale and not retail prices have been taken; (2) each crop has been separately estimated, province by province, and an approximate figure has not been taken for food-grains per ton, nor for all other commodities taken together a similarly approximate figure per acre. If the old method were followed in preference to the more elaborate method the values in column 3 for 1911, 1921, and 1922 would have been Rs.876, 1302, and 1529 crores respectively; in column 4 Rs.328, 469, and 550 crores; in column 5 Rs.1204,

11. The *per capita* figures in the above table are apt to mislead unless it is remembered that they represent the average per head, including not merely the adult male but the adult female and child. The *per capita* figure has sometimes been assumed to refer to the wage-earner of a family, whereas it is the *per capita*, i.e. total income divided by total population. This *per capita* figure does not give any indication of the distribution of wealth, which is a very important factor in taxable capacity.¹ Indeed Marshall suggests, "A rough opinion of the economic strength of a nation . . . may be got by the multiplying the aggregate income of the inhabitants by their average income".² Hoards in the form of gold and silver have been already referred to. Since 1873 the net additions to the stock of gold in India have been the equivalent of nearly five times³ last year's world production.⁴ India takes this gold from habit, and it cannot be taken as an index of prosperity to the same degree as an import of the same magnitude in western countries. India prefers to take gold instead of securities or even merchandise. Habit dies slowly. With the growth in education and the progress of sound banking, especially the Imperial Bank, hoarding should tend to weaken.

The *per capita* figure of 107 in the table above for 1921, a year below normal, and 116 in 1922 should be compared with Rs.149-6-0, the annual *per capita* income of the working classes

1771, and 2079 crores, and the *per capita* figures would have been Rs.50, 72, and 85 respectively. The figures of income in the table above for 1921 and 1922 allow, as explained in paragraph 12, for industrial development.

¹ The distribution of wealth in India is extraordinarily uneven, a point to which attention will be drawn in the chapter on income tax.

² This is in accordance with the mathematical law, which states that if A varies as B when C is constant and varies as C when B is constant, then A will vary as $B \times C$ when both B and C vary. A simple illustration of this is that if two rooms have the same length that which has the greater breadth has the greater space or area, and if two rooms have the same breadth that which is the longer has the greater area. Hence in comparing the size of two rooms the quantity length \times breadth is taken. Similarly in two countries having the same average national income that country which has the greater aggregate national income is economically the stronger. If two countries have the same aggregate income that which has the greater average income (thereby showing a greater aggregate income for a smaller population) is economically the stronger. Hence Marshall's suggestion above.

³ The exact figures were Rs.481,27 lakhs (£312 millions) the net additions to the stock of gold in India, and the world's production in 1922 Rs.97,50 lakhs (estimate). *Vide Indian Finance and Banking*, by G. Findlay Shirras, p. 454.

⁴ 1922.

in the industries of Bombay (City and Island) ¹ during the same period.

12. A few remarks are necessary with regard to the calculation of non-agricultural income. Mr. Dadabhoy Naoroji estimated the non-agricultural income by adding together the annual value of manufacturing industries, the net opium revenue, the cost of production of salt, the produce of coal and other mines, the profits of foreign trade and a figure which he estimated at Rs.30 crores ² for contingencies. The total non-agricultural income arrived at was Rs.63 crores based on data for the year 1868. The criticism of this method is that it was incomplete owing to the absence at that time of full and accurate statistics regarding production in this country. Even to-day, although the taking of a census of production has been mooted more than once in the Central legislature, there has been no inquiry comparable with the Census of Production in England or similar censuses in the Dominions or in the United States. In the inquiries which have been made between 1881 and 1911 it was assumed that the gross income of agriculturists and non-agriculturists is distributed between the two classes in proportion to their numbers. If the total agricultural produce or income in 1911 was Rs.876 crores, and if the non-agricultural population were three-eighths of the agricultural population, then the non-agricultural income was estimated to be three-eighths of Rs.876 crores, that is Rs.328 crores. When a country was industrialised to only a small degree, as was the case before the rapid changes that have been taking place, especially in the last decade, the method was perhaps approximately correct, but industrial progress in recent years has been so great that some additional allowance is necessary to arrive at the total non-agricultural income. An examination of the income tax statistics is of use in this connection. The number of incomes over the Rs.2000 level assessed in 1919-20 was nearly 95 per cent greater than those in 1910-11. A portion of this increase is to be attributed to the better methods of collection introduced since 1919, but the greater portion is certainly due to an average increase in income.

¹ *Report on an Enquiry into Working Class Budgets in Bombay*, by G. Findlay Shirras. Government Printing, Poona, 1923.

² A crore is ten million (rupees). At the then rate of exchange, i.e. 2 shillings to the rupee, the sterling equivalent is £30,000,000.

The difficulty of arriving at a figure for the non-agricultural income of India for the year 1921-22 arises from the fact that in that year, as is well known, non-agricultural and industrial incomes show a greater increase as compared with agricultural income over the pre-War year. It should be remembered that what is attempted here is not the value of the net output of industrial and manufacturing concerns, but the total value of the services of all those who are not engaged in agriculture, which includes the value of the output of these concerns. As explained in Chapter XXIX. the definition of the income of a nation is not the value of the net output but the value of the commodities produced and the services performed in a twelvemonth in exchange for money. The sum of 75 crores was added to 808 crores, as this was taken after examination as the amount necessary (to add to 808 crores) on account of the greater increase in non-agricultural incomes. This gives a total of 883 crores. It was necessary to check this figure with other available data, and for this purpose a study of the occupation tables in the last census report was undertaken together with the approximate earnings in each industry. These are set out below :

BRITISH INDIA ONLY

Occupation.	Number of actual Workers.	Approximate Annual Earnings per Worker.	Aggregate Annual Earnings.
	Millions.	Rs.	Rs. crores.
Industry	15.7	240	375
Mines . . . . .	.2	180	4
Transport	2.0	300	60
Trade	8.0	500	400
Public administration	1.0	150	15
Public force	1.0	150	15
Professions and the Liberal arts	2.1	500	100
Domestic service	2.5	200	50
Total	32.5	—	1019

As regards industry, this includes all industries whether in factories or at home. The figures of actual wages were arrived at after an examination of the available wage statistics industry by industry. The rate of wages for miners was Rs.15 per month, and for those engaged in transport Rs.25 a month, as this figure

includes employees in railways, tramways, drivers of motor cars, workers engaged on roads and bridges, etc. It was difficult to arrive at the approximate earnings of the group "trade", as there are extremes from the rich merchants in cities to small petty traders. The figure for public administration, Rs.15 crores, is also on the safe side, because Government spends on public administration more than this sum. Similarly the professions and liberal arts include lawyers, professors, doctors, etc., and domestic servants include cooks, butlers, chauffeurs, gardeners, washermen, etc. The annual income of Rs.200 for domestic servants was based on wages paid outside Bombay city and throughout the Bombay Presidency. The total thus comes to Rs.1019 crores, and allowing the probable error of 10 per cent, this would, at a minimum, be 900 crores. This figure may be further tested by adding to the non-agricultural income of British India in the pre-War year (530 crores) the increase of 60 per cent, a rise in the wholesale index number. This would give 850 crores. It might be argued that production may not at the present time be equal to that in the pre-War year. The available data, however, for 1922 show that the production is certainly not less. The consumption of coal has increased from 15.1 million tons to 26.7 million tons in 1922, the weight of goods carried by railway 82.6 million tons to 87.5 million tons, seaborne trade Rs.427 crores to Rs.535 crores, exports of Indian merchandise Rs.244 crores to Rs.349 crores. The production of coal has gone from 16.2 million tons to 19 million tons, salt 1.5 to 1.7 million tons, and petroleum 278 to 299 million gallons. All things considered, it may be seen that the figure for 1920-21 and 1921-22 of 883 crores is not far out.¹

¹ Production may be low in one country as compared with another, owing to, among other causes, unemployment. The case of unemployment in England is an illustration in point. In India the work done by the average cultivator in the Punjab does not represent more than about 150 days' full labour in 12 months, and even in the occupied days the idea of the Indian cultivator of what constitutes a full day's task is well below that prevalent in more progressive Western countries. Besides there is a vast waste of female labour due primarily to custom and prejudice. Moreover, the cultivated area per agricultural worker is very low in India. It is 5.7 acres for the Bombay Presidency, 2.7 acres for British India, Native States and Agencies, and for all India, 6.1 acres for the Union of South Africa, 21 acres for Great Britain, 25.6 acres for the Commonwealth of Australia, and 45.8 acres for the United States of America. Cf. Mr. Calvert's *The Wealth and Welfare of the Punjab*, Lahore, 1922; and also the *Census of India*, 1921, vol. i. part i.

THE TAXABLE CAPACITY OF INDIA

13. With the data above it is now possible to show how the taxable capacity of British India may be roughly measured. The two census years, 1911 and 1921, together with the year 1922, have been taken for this purpose. The year 1920-21 is, as already noted, a very abnormal year, and on this account the figures of taxable capacity for that year will vary, especially in an agricultural country such as India, to a very large extent. The variations between 1921 and 1922 in the case of India should be compared with the variations in the table on p. 137 relating to the taxable capacity of the United Kingdom, where the industrial depression of 1921 was the worst probably since the time of the

THE TAXABLE CAPACITY OF BRITISH INDIA

Details.	1910-11 (Census 1911).	1920-21 (Census 1921, a distinctly bad year).	1921-22 (good for Agriculture, but year of Trade Depression).
	Lakhs of Rs.	Lakhs of Rs.	Lakhs of Rs.
1. Income :			
Agricultural	1412,00	1715,00	1983,00
Non-agricultural	530,00	883,00	883,00
Total income	1942,00	2598,00	2866,00
2. Allow for minimum consumption	1214,00	2220,00	2220,00
3. Allow for seed and manure	141,00	172,00	198,00
4. Allow for replacement of and ordinary additions to capital	25,00	45,00	55,00
5. Taxable capacity (1, 2, 3, 4)	562,00	161,00	393,00
6. Tax revenue :			
Central and Provincial Governments	79,83	130,15	135,30
Local bodies *	7,17	11,64	11,64
Total	87,00	141,79	146,94
7. Expenditure on internal debt :			
Central and Provincial Governments	5,61	21,04	24,27
Local bodies	1,70	2,34	2,34
Total	7,31	23,38	26,61
8. Effective taxation (6-7)	79,69	118,61	129,33
9. Balance (5-8)	482,31	42,39	272,64

* The figures given for local bodies are for the year 1919-20, later figures not being available.

Napoleonic wars. A year of scarcity or famine in India is a year of agricultural unemployment, and may be compared with industrial unemployment in an advanced industrial country. The effect is in the first place a shrinkage in aggregate income and, therefore, of taxable capacity. Most of the figures in the preceding table are self-explanatory.

14. The allowance for minimum consumption has been arrived at after a study of family budgets collected by the Labour Office of the Government of Bombay, and the figures have been corroborated by similar inquiries elsewhere. The standard of comfort is an elastic term, and taxable capacity will vary with different standards of comfort. In India the standard is low, and one looks hopefully to education and greater productivity as a means to the raising of this standard of living. We take then the standard of living as it is and not what it ought to be. In 1910, for example, Jack in his *Economic Life of a Bengal District*¹ calculated that an average family of five persons required Rs.240 a year for subsistence. This gives a consumption allowance of about Rs.48 per head for the year 1910. But since that date, *i.e.* nearly five years before the War, prices of food-stuffs increased by nearly 90 per cent in 1922. In other words, Rs.48 in 1910 would be Rs.90 in 1922. The allowance for seed and manure has been taken at 10 per cent, although Mr. Dadabhoy Naoroji took only 6 per cent, and agricultural experts frequently a figure below that taken in the table above. For the replacement of capital 10 per cent of the paid-up capital of Joint Stock Companies has been taken. The average working life of a textile machine is ordinarily taken as ten years. Robertson in his *Study of Industrial Fluctuations* says: "In Lancashire, at the present day, according to an expert informant, it is usual to write down the value of engines and boilers by 10 per cent per annum".² Fifteen crores have been allowed for additions to capital in 1920-21, and 25 crores in 1921-22. The figures in the table of taxation should not be confused with the figures of total Government revenue. They refer to tax revenue only. The expenditure on internal debt has to be subtracted for reasons already given, as it is in effect a transference of money from one pocket to another.

¹ P. 59 (Clarendon Press, 1916).

² P. 41 (P. S. King & Son, Ltd., 1915).

15. Two main features stand out in this table, and these are : (1) the large variation between a good and a bad year in regard to income and taxable capacity. India depends at the present time on the monsoon, which may be said to be the jugular vein of Indian prosperity. As years go on, more and more irrigation projects are launched to prevent as far as practicable the risks entailed in this respect, but as we shall see in a future chapter systematic remissions of land revenue are in vogue. (2) The taxable capacity is not so high as in an advanced industrial country like Great Britain. In 1921-22 the taxable capacity was in the neighbourhood of Rs.393 crores, but the effective taxation, *i.e.* taxation minus interest on internal debts and debt repaid, was Rs.120 crores, leaving a balance of something in the neighbourhood of Rs.273 crores. In a bad year like 1920-21 the balance, as will be seen from the table, was much less, as was to be expected. The effective taxation as already defined was in India 4 per cent of the gross income, as compared with 24 per cent in the case of Great Britain. In India 30 per cent of what might have been taken, *i.e.* total taxable capacity, was taken by public authorities in the form of taxation as against 82 per cent in the United Kingdom. These figures, however, must not be interpreted too rigorously. The reservation of the standard of living applies to all these figures. The standard of living is much higher in Great Britain, and ultimately Great Britain can stand much higher taxation. That explains why 82 per cent taken from total taxable capacity did not lead to the same hardships as the same percentage might do in a country with a lower standard of living. Again it must be emphasised, with almost wearisome iteration, that the taxable capacity of British India is not an absolute amount. It is possible only roughly to indicate the direction in which this limit lies. A great deal depends on the purposes for which the taxation is imposed, and on the extent to which the tax proceeds are spent inside or outside the country. Again great care has to be taken in making comparisons. "The best possible criterion of the relative means and ability", says Lord Castle-reagh, "of two countries to bear taxation is the produce of an income tax levied on the same description of incomes in both, and equally well levied in both." The mere statement of this proposition shows how difficult of attainment it is. No test can be looked on as more than an approximation. Any person who

skates over these difficulties with lightness and agility deserves to be treated like the mimic and acrobat in Plato's *Republic*. That pantomimic gentleman was congratulated on his accomplishments, crowned with garlands, and then led to the gate of the city and bade never to return.

CHAPTER XVI

THE DISTRIBUTION OF CENTRAL, PROVINCIAL, AND LOCAL REVENUES

1. THE distribution of public revenues between Central or Federal, Provincial or State Governments, and purely local authorities, is, it need hardly be said, largely determined by historical considerations. In a study of the separation of revenues country by country the importance of this becomes clear. The distribution suitable in one country may not be equally suitable in another where different conditions obtain. That indeed is a commonplace. Nevertheless it is possible to lay down a few principles based on a study of recent Budgets in the more important countries.

2. In non-federal countries, such as Great Britain and France, the separation between the Central Government and local authorities is not without interest. Here again this is usually determined by the history of each particular country, and hasty generalisations have to be avoided. In 1922-23 the Budget estimate for Great Britain (and N. Ireland) was £911 millions, of which nearly £730 millions or 80 per cent was tax revenue and £181 millions or 20 per cent non-tax revenue. The main heads in order of importance are shown in table on following page,

To Local Taxation Accounts there are paid out of the Consolidated Fund sums equivalent to the proceeds, in some cases of the year 1908-9 and in other cases of the current year, from excise licence duties, part of the beer and spirit duties, and part of the probate and estate duties. Certain other grants are also payable. In 1921-22 the total payments were over £11 millions, of which £8,445,000 were to England, £1,275,000 to Scotland, and £1,451,000 to Ireland. Local revenue in Great Britain in 1917-18

was made up of rates or taxes 42·3 per cent, prices or receipts from public undertakings (water, gas, electric light, tramways and light railways) 26·3 per cent, Government contributions 14·2 per cent, loans, 2·6 per cent, and miscellaneous 14·6 per cent. The

	Pre-War.	1922-23 (estimates).	Percentage to Total.	
			Pre-War.	1922-23.
	Million £.	Million £.		
Tax revenue :				
Direct :				
Income tax	47·2	329·0	23·8	36·1
Estate, etc., duties	27·4	48·0	13·8	5·3
E.P.D. . . . .	..	27·8	..	3·0
Corporation taxes . . . . .	..	19·8	..	2·2
Motor vehicle duties . . . .	..	10·6	..	1·2
Land and house tax	2·7	3·0	1·4	0·3
Land value duties	0·7	..	0·3	..
Total direct taxes	78·0	438·2	39·3	48·1
Indirect taxes :				
Excise	39·6	160·8	20·0	17·7
Customs	35·5	112·3	17·9	12·3
Stamps	10·0	18·3	5·0	2·0
Total indirect taxes	85·1	291·4	42·9	32·0
Total tax revenue	163·1	729·6	82·2	80·1
Non-tax revenue :				
Miscellaneous	2·3	112·0	1·2	12·2
Posts, telegraphs, and telephones	30·8	54·6	15·5	6·1
Suez Canal shares . . . . .	..	14·0	..	1·5
Sundry loans	1·6	..	0·8	..
Crown lands	0·5	0·8	0·3	0·1
Total non-tax revenue	35·2	181·4	17·8	19·9
Total revenue	198·3	911·0	100·0	100·0

total revenue of local authorities in England and Wales in 1917-1918 was £176·6 millions, and of Scotland £24·3 millions. In 1919-20 this had risen to over £258 millions. The total revenue of local authorities in Ireland in 1917-18 was £9·3 millions, later figures not being available.

3. The principal sources of ordinary revenue of the Dominion (or Federal) Government of Canada are customs, excise, the post office, interest on investments, and, above all, war tax or income-

tax revenue. War-tax revenue, according to the estimates for 1921-22, was 46·3 per cent of the Consolidated Fund or ordinary revenue, while customs amounted to 28 per cent, excise to 9·7 per cent, and the post office 7·0 per cent. Provincial revenues are approximately for the nine provinces the equivalent of 28 per cent of central or Dominion revenues. In India the total provincial revenues (nine provinces) are the equivalent of 61 per cent of central revenues. The Canadian Provincial Governments obtain their revenue from a land tax, forests, mines, game, and fisheries. Local authorities have, as in India, sources such as property, certain fees and prices.

4. In the Commonwealth of Australia the two main sources of Federal revenue are customs (27 per cent, 1921-22), and income tax (24 per cent). Other main sources are : excise, posts, telegraphs, and telephones, a land tax, probate and succession duties, entertainments taxes, and a war-time profits tax. Half of the State or provincial revenues are from taxation, and the remainder from provincial works and services such as railways and tramways, water supply and sewerage. Local taxation is mainly derived from general rates upon property supplemented in some cases by revenue from water supply and other works.

5. The main sources of Federal revenue in the Union of South Africa are income tax (28 per cent, 1922-23 estimates) and customs (20 per cent). The next important heads are interest (19 per cent), posts, telegraphs, and telephones (10 per cent), excise (6 per cent), mining, stamp duties and fees, native taxes, departmental receipts, estate and succession duties, and fines and forfeitures. The provinces of the Union depend upon subventions or grants from the Union amounting to nearly half of the total revenue. The other sources of provincial revenue are the transfer duty, general licences, Provincial Property Tax and other miscellaneous taxes,¹ and for local authorities the main sources of income are general rates upon property, water rates, market fees, and electric supply.

6. In India, under the Constitution of 1919, central revenues include two main sources—customs and income tax. Other sources are taxes from salt and opium, tributes, and certain other heads, “ non-tax ” in character, such as railways, posts and tele-

¹ *Vide* Sections 89 and 117 of the Union of South Africa Act, 1909 (*vide* 1921 *Official Year-book of the Union of South Africa*, pp. 87 and 90).

graphs, coinage, military and other miscellaneous receipts. Provincial heads of revenue include mainly land revenue and excise. Other sources are stamps, registration, irrigation, and forests. Under the Government of India Act Rules the Legislative Council of a province may, without the previous sanction of the Governor-General, make and take into consideration any law imposing, for the purposes of the Provincial Government, any of the following taxes: (1) a tax on land put to uses other than agricultural; (2) a tax on succession or on acquisition by survivorship in a joint family; (3) a tax on any form of betting or gambling permitted by law; (4) a tax on advertisements; (5) a tax on amusements; (6) a tax on any specified luxury; (7) a registration fee; and (8) a stamp duty other than duties of which the amount is fixed by Indian legislation. The Governor-General in Council may at any time by order make any addition to the taxes enumerated above. In all other cases under the Constitution¹ the local legislature has to have the previous sanction of the Governor-General. Thus the Central Government rightly reserves to itself what is not specifically mentioned unless it wishes to delegate the power to the Provincial Government by enlarging the schedule. Local authorities are similarly empowered in certain circumstances to impose the following taxes, cesses, rates, duties, or fees: (1) a toll; (2) a tax on land or land values; (3) a tax on buildings; (4) a tax on vehicles or boats; (5) a tax on animals; (6) a tax on menials and domestic servants; (7) an octroi; (8) a terminal tax on goods imported into a local area in which an octroi was levied on or before the 6th July 1917; (9) a tax on trades, professions, and callings; (10) a tax on private markets; (11) a tax imposed in return for services rendered, such as (a) a water rate; (b) a lighting rate; (c) a scavenging, sanitary, or sewage rate; (d) a drainage tax; (e) fees for the use of markets or other public conveniences. This list of sources of revenue is quoted from the Rules under the Government of India Act. The distinction between tax, fee, and price, it will be seen, has not been made. In regard to the list the Governor-General in Council may at any time, by order, make additions also to this schedule. The Provincial Governments have to contribute annually a quota fixed for each province, and this is a first charge on provincial revenues. Until recently the German Empire also was supported by propor-

¹ Section 80A, 3 (a), of the Government of India Act, 1919.

tionate State contributions—*Matrikular-beiträge*—just as was the Federal Government of the United States under its First Constitution. The reverse system, viz. payments from the Central or Federal Government to Provincial or State Governments, is in force in the self-governing Dominions of Canada, Australia, and the Union of South Africa. From 1921 to 1922 onwards a contribution from Provincial Governments to the Government of India of Rs.983 lakhs (£6·6 millions) is made. It is the intention of the Government of India to do away with this contribution as early as practicable. In cases of emergency and with the sanction of the Secretary of State excess contributions may be levied. Some provinces, such as Bombay, have already introduced an entertainments tax, while others, such as Madras, for local purposes a professions tax. No province, however, has in practice a system of general property taxation broadly on the lines of State and local authorities in the United States. Nor are there succession duties, which are, as seen above, provincial not central. A reference to this in regard to the financing of social services, notably universal primary education and public health, will be made in a subsequent chapter.

7. In the United States the main source of federal revenue is the income tax. Out of ordinary receipts for the year ended June 30, 1922, amounting to \$4,104,000,000, no less than \$2,087,000,000 or 51 per cent was from income and profits taxes. Customs was the next important head (8·7 per cent), followed by miscellaneous heads such as the sale of Government property, coinage profits, fines and forfeitures, interest on public deposits, and interest on loans to foreign Governments. With one or two exceptions indirect taxes are devoted to general purposes. For State and local authorities the general property tax on real and personal property is by far the main source of revenue. The tax is assessed by local authorities with additions for the State or, as they are called, "Commonwealth" governments.¹ The purely local, county, and State rates are arrived at by dividing the assessed valuation of the property in the locality by the amount required for local, county, and State purposes. Thus the final tax rate upon property is arrived at by adding these rates. The assessment and the collection of the tax, however, are in the

¹ This should not be confused with the Commonwealth Government as used in Australia. In the latter case it refers to the Federal Government.

hands of local authorities. In some of the States of the Union the inheritance tax and corporation taxes are now assigned to the State as a source of revenue, while the local authorities depend on the property tax. In California, and to a certain degree in New York, there is a separation of revenue between the State and local authorities. As a general rule it may be said that in the United States the income tax and customs are the main sources of federal revenue, the general property tax, corporation, licence and inheritance taxes of State revenue, and for local authorities such as municipalities, counties, townships, and school districts the main sources are the general property tax supplemented by local licence taxes. The framers of the admirable Constitution wisely provided that "all duties, imposts, and excises shall be uniform throughout the United States"; that "no tax or duty shall be laid (by Congress) on articles exported from any State"; and that "no State shall, without the consent of the Congress, lay any impost or duties on imports or exports, except what may be absolutely necessary for executing its inspection laws". This guarantee in the Constitution has been of great value to the foreign trade of the United States.

8. The distribution of revenue heads in France is of peculiar importance. Prior to 1914 French taxes were derived from four main sources, viz. the so-called direct contributions, the so-called indirect contributions, consumption taxes, and customs duties on a large number of imports. The direct contributions were taxes levied on lands and houses, doors and windows, the letting value of houses occupied by the taxpayer, and licences for occupations. The indirect contributions were taxes upon transferable securities. Consumption taxes were levied on French produce, for example, on alcohol, wine, and sugar.

Changes in the French revenue system between 1914 and 1920 have affected not only the Central Government but also local authorities. In July 1914, just before the War, the first general income tax law passed by Parliament was placed on the statute book. Besides this general income tax there are now three other forms of taxing incomes. (1) The old direct taxes, popularly known as "the four old women", were done away with by the laws enacted on 29th March 1914, 31st July 1917, and 25th June 1920. The direct taxes on real estate were converted into taxes on the income from real estate—5 per cent of the taxable income

derived from unimproved real estate, and 4 per cent of the net income on improved real estate. Moreover, the tax was after 1st January 1915 not an apportioned tax and the quotas to be paid by departments, and communes were discontinued by the law of 31st July 1917. (2) The old taxes on doors and windows, trades and professions, and the contribution *personnelle et mobilière* (at first a tax on the letting value of real estate, but later a house tax combined with a personal tax based on the value of three days' labour) were succeeded for State purposes by schedule taxes upon industrial, commercial, and agricultural profits, and upon salaries, wages, pensions, annuities, and professional incomes. (3) The third tax on income is the tax on income from transferable securities—stocks and bonds. The tax applies to income from dividends, interest and all other income derived from stocks, bonds and interests in partnership (*commandites*) either foreign or domestic, income from mortgages, fixed deposits, and money deposited as security. The business turnover tax, to be discussed later, is also an important tax introduced in the 1920 Budget. Other taxes are old taxes, such as the registration and stamp taxes, customs duties, excise and consumption taxes. These taxes are supplemented by the profits from State monopolies, the most important being tobacco, matches, and the post office, the telephone, and the telegraph.

In regard to the receipts of local authorities it is only departments and communes that have Budgets.¹ The revenues of the departments and communes are derived from three sources: (1) from collections made on their behalf by the Central Government; (2) from a share of Central Government's revenues; and (3) from direct local taxes. Since the Revolution the State collected in addition to "the four old women" an additional percentage (*centimes additionnels*) for the benefit of local authorities (departments, communes, etc.). These were mainly on carriages, horses, mules, billiards, clubs, the verification of weights and measures, and on mining rents. When the changes referred to above came into operation Government undertook to collect, until some other plan was evolved, *centimes additionnels* on the old basis for local authorities. By the law of 25th June 1920 an additional tenth of one per cent was added for the benefit of communes to the turnover tax to enable them to balance their

¹ See Chapter "Local Taxation" (Chapter XXXI.).

Budgets. Other sources of revenue of the local bodies are generally public utilities like water, electricity, gas, sewers, etc., and the octroi. The city of Paris levies a special tax on amusements. It covers all kinds of amusements, and not even balls, concerts, and museums are exempted.

The change in the distribution of revenue of a country is always an interesting study, but rarely is it more interesting than in France during the period 1914 to 1920. A useful lesson is afforded by the way in which local authorities have been financed.

9. The Central or Federal Government of Germany entered, as we have seen, the War with an undeveloped system of finance.¹ She possessed no elastic source of revenue, although the brunt of the costs of the War fell on the Imperial Treasury. She had almost entirely to finance the War by loans, as it was not anticipated in 1914 that the War would be a long and expensive affair. When defeat occurred, the financial system was already in a state of chaos. It was essential that the Central Government, the Reich, should no longer be deprived of the chief sources of revenue. Direct taxation, hitherto a State head of income, had to be made free for the Central Government. This was achieved by the National Taxation Law of 22nd March 1920, when the relations of the Reich, the States, and local authorities were put on a new basis. Certain sources of taxation were no longer reserved for the States. In fact the position was reversed. Heads of revenue were definitely reserved for the Central Government, and the individual States and local authorities, such as counties and municipalities, were not to collect similar taxes unless permitted expressly to impose a supplementary levy. This was a great step forward in regard to the placing of the Reich's finances on a more satisfactory basis. The central Finance Department controlled under the law of 1920 the income, inheritance, land transfer, and turnover taxes, and assigned a portion of the collections to the States. Two-thirds of the income tax,² one-fifth of the inheritance tax, half of the land transfer tax, and three-twentieths of the turnover tax were apportioned to the Provincial Governments or States. The assignment to purely local authorities was left to the States except in the turnover tax, where 5 per cent went to municipalities.

¹ See p. 82.

² For income tax in local taxation see Chapter XXXII.

Indirect taxes up to 1920 were reserved for the Federal Government, although to a less extent than in the United States. For the year 1922-23 the main sources of the Reich's revenue were still the indirect taxes, viz. on coal, turnover, customs, tobacco, beer, and wines. These amounted to 50 per cent of the estimated revenue. The income tax amounted to 22 per cent and a capital levy to 7 per cent of the total revenue of the Reich in the same year. Taxes on income are now levied by the Central Government in three ways—a unified tax on earned income, a super tax on income from investments, and a companies tax which operates as a super tax on enterprises carried on by companies. Taxation on capital (property) is also imposed in three ways—a war tax on property increase, the “need of the Reich” tax on unincreased property, and a heavy inheritance duty. The scope of the indirect taxes also has been considerably extended. For example, the turnover tax includes a restaurant tax, an advertisement tax, and a cloakroom tax. Matches and playing cards are taxed, and the charges on letters, telegrams, postal orders, trunk-telephone messages, and railway rates have been repeatedly increased.

It will be clear that in spite of different, often widely different, conditions prevailing in various countries there is a considerable degree of uniformity in regard to Federal sources of revenue. Income tax and customs are two expansible heads and are usually regarded as pre-eminently suitable as “central” sources of revenue. The Federal Government has to assume the responsibility for external affairs and defence. In times of emergency, therefore, these can be expanded and supplemented by a judicious use of loans.

10. To sum up, the distribution of public revenues between central, provincial, and purely local authorities conforms in the long run to certain general principles. Customs and income tax are, for example, particularly suited to be central heads of revenue. A general property tax, if carefully assessed, and excise taxes are similarly suitable objects of provincial taxation, while a tax on house rent, local assessments, and local licences are specially fitted for purely local taxation. Sources of revenue are not, as in India and most countries, always separated, some being utilised for central or Federal requirements, others for provincial or State purposes, and others for the benefit of purely local authorities.

If carried to extremes the principle of separation of revenues may result in the divided revenues being inadequate. Part, however, of the yield of central or provincial taxes may be assigned to local authorities. Lump sums may be made in the form of subventions by central to provincial authorities or *vice versa*. The separation of sources plus a division of yield when the yield is an abundant one is a very workable policy, and it does not interfere with the freedom of local authorities.

In some cases taxes assessed from above may, as in France, have additions for local purposes. There is much to be said in favour of this as it makes, as Leroy-Beaulieu says, "the management of local finance simpler, clearer, and less costly, and gives the taxpayers much greater security against speculation and exaction". There is, however, the ever-present danger that interference with the maximum productivity of the tax may take place, a danger inherent in all single taxation. This method should not cramp local authorities and leave them without sufficient latitude to work out their own destiny. If there is a marked difference in the percentage fixed between one Provincial Government and another, shifting of capital and consequent evasion may result.

When taxes are assessed by local authorities and additions made, as in the case of the property tax in the United States, for Provincial Governments there is a tendency to under-assessment. In all cases, however, of the distribution of revenues the principles of adequacy, suitability, and administrative efficiency should not be forgotten. In short, the heads of revenue should be adequate for ordinary requirements in each case; they should be distributed according to the functions each public authority performs; and, thirdly, apportioned so that they can be easily and efficiently administered.

CHAPTER XVII

THE DISTRIBUTION OF THE BURDEN OF TAXATION WITH SPECIAL REFERENCE TO PROPORTIONAL, PROGRESSIVE, AND DOUBLE TAXATION

ONE of the most important questions of taxation is the proper distribution of its burden. This may be viewed from two stand-points : (1) the distribution of the burden among the taxpayers within the State, and (2) the distribution between States. This latter question raises the difficult problem of double taxation between countries.

THE BALANCE BETWEEN DIRECT AND INDIRECT TAXES ¹

1. Discussions on the subject of distribution usually take account of the direct but not of the indirect burden of taxation. There is no real reason why this should be so. The distribution of tax revenue, for example, in India and the United Kingdom among direct and indirect taxes is seen in the following tables :

INDIA

Heads of Revenue.	1871-72. 50 Years ago.	1911-12. 10 Years ago.	1913-14. Pre-War Year.	1921-22.
	(Percentages)			
Land revenue . . .	45·9	39·7	41·5	25·8
Other direct taxes . .	3·5	5·4	5·4	19·2
Total direct taxes . .	49·4	45·1	46·9	45·0
Indirect taxes . . .	50·6	54·9	53·1	55·0
Total tax revenue . .	100·0	100·0	100·0	100·0

¹ See also Chapter XXIX.

UNITED KINGDOM

Heads of Revenue.	1901-2. 20 Years ago.	1911-12. 10 Years ago.	1913-14. Pre-War Year.	1921-22.*
	(Percentages)			
Income tax	28.5	28.9	28.9	46.6
Other direct taxes . .	13.7	18.6	18.9	13.2
Total direct taxes . .	42.2	47.5	47.8	59.8
Total indirect taxes . .	57.8	52.5	52.2	40.2
Total tax revenue . .	100.0	100.0	100.0	100.0

* Great Britain and Northern Ireland.

It will be seen that over long periods there are great changes. There is, however, as the detailed table XXIV, App., will show, a tendency towards the personal taxation of income becoming more predominant in national taxation. There is no necessary relation between direct and indirect taxation, and in every country this is the result of historical influences. Those who speak of a balance between direct and indirect taxation are apt to assume that direct taxes are paid by the rich and indirect by the poor, and also that the totals paid by the rich and by the poor should be in some constant ratio. This is not borne out in practice, as indirect taxes on luxuries are paid by the rich and direct taxes on low incomes are paid by the poor.¹ Circumstances may arise that may make it expedient to change the existing ratio between direct and indirect taxes, even if the relative wealth of these two classes has or has not changed. It is true that a large use of indirect taxes presses, other things being equal, on the poorer classes of the population, while inheritance and income taxes fall chiefly on the wealthier classes. In imposing taxation the Finance Minister has to study the broad effects not merely of a single tax but of other taxes on the financial condition of the body of taxpayers as a whole. He is aware, too, that indirect taxes are not felt by the taxpayer in the same way as direct taxes. Indirect taxes, in short, are more easily disguised, and, as Adam Smith says, the person taxed "pays them by little and little as he has occasion to buy the goods".² The financier always attempts, sometimes without success, to make the real burden as light as possible. This raises the principle of minimum sacrifice, to which we shall shortly return.

¹ See also Chapter XXV.² *The Wealth of Nations*, Book V. chap. ii.

TWENTIETH-CENTURY CHANGES IN THEORY AND PRACTICE

2. The problem of distribution is an ethical question, but it raises financial and economic issues of no small importance. Towards the closing years of the nineteenth century the problem of the proper distribution of the burden of taxation received new life owing to the work notably of Seligman¹ in America, and of Italian writers like Mazzola,² Mase-Dari,³ Graziani,⁴ and Ricca-Salerno,⁵ and of Dutch writers like Cohen-Stuart⁶ and Pierson.⁷ The work of Edgeworth on *The Pure Theory of Taxation*⁸ was also of high value. The twentieth century witnessed a considerable advance in practical finance. On 25th February 1913 the ratification of the Sixteenth Amendment of the American Constitution provided for the foundation of a Federal income tax: "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration". In that code of taxation, the British income tax, the principle of graduation was definitely adopted in 1910 after a long struggle, and in the Finance Act of 1914 a further attempt was made at a more complete graduation. In August 1918 the Income Tax Act was passed by Parliament, and 13 Acts and parts of 39 others were repealed by this consolidating Act.

DEFINITION

3. It will be convenient to define one or two terms which arise in all discussions on this subject. Graduated taxation usually means that the rate of the tax increases as the amount of income, property, etc., increases. Graduated taxation is commonly taken to mean taxation graduated upward, *i.e.* it is meant to imply progressive taxation. If graduation is downward (*i.e.* the larger the taxpayer's income the less the proportion contributed), it is known as regressive taxation. When all incomes below a certain amount are exempt from taxation or rated only in part

¹ *Progressive Taxation in Theory and Practice*, 1894.

² *L'Imposta progressiva*, 1897.

³ *Ibid.*

⁴ *Istituzioni di scienza delle finanze.*

⁵ *Passim.*

⁶ *Bijdrage tot de Theorie der progressieve Inkomstenbelasting.*

⁷ *Political Economy*, vol. ii. (translated by Wotzel), Macmillans.

⁸ *Economic Journal*, vol. vii., 1897.

and all above this sum are taxed proportionally on the surplus this is known as degressive taxation. The taxation of income in Zurich is a case in point. Proportional taxation means the same proportion is contributed by the taxpayer on all amounts of the income, property, etc., taxed.

THEORIES OF JUST DISTRIBUTION

4. Three theories on the just distribution of the money burden of taxation are usually put forward: (1) the taxation should be measured by the cost of service rendered to individual taxpayers by the public authority; (2) by the benefit to individual taxpayers of such service; and (3) by the individual ability to pay taxation. The cost of service cannot be applied to services paid for out of the proceeds of taxes as against prices. The cost, as pointed out in the definition of taxes, prices, and fees, cannot in the case of taxes be determined. A tax is a compulsory levy taken from all alike and without any regard to the use by the individual of the services supplied. Thus the "cost of service" principle is not of practical application. Similarly, since the cost of services rendered to individual taxpayers cannot be determined, the benefits cannot also be determined except in a few rare cases such as old age pensions. The pensioner would, under the benefit of service principle, have to return his pension to the Treasury. If exceptions or qualifications are to be made, then it is not clear on what principle and to what extent such exceptions should be made. In short, we are driven back to the "ability" or "faculty" theory.

THE ABILITY OR FACULTY THEORY

5. In Great Britain the term "ability" first appears in the Elizabethan poor law, where the taxes are fixed "according to the 'ability' of the parish". Faculty is the old mediæval word, *e.g.* "*juxta bonorum facultatem*" or "*pro bonorum facultate*". Ability or faculty meant at first property and then income. Adam Smith takes the term to mean "revenues". What is the method by which ability or faculty to pay is to be measured? If emphasis is laid on the subjective side, the inconvenience or sacrifice involved in the payment of taxes will be clear; if on the

objective, the ability or faculty of the taxpayer (as shown by his "income") will come into prominence. "Equality of taxation", according to Mill, "as a maxim of politics, means apportioning the contribution of each person toward the expenses of government, so that he shall feel neither more nor less inconvenience from his share of the payment than every other person experiences from his." Mill, however, also seems to flirt with the principle of least sacrifice when he says that "Whatever sacrifices it (a Government) requires from them (persons or classes) should be made to bear as nearly as possible with the same pressure upon all, which, it must be observed, is the mode by which least sacrifice is occasioned on the whole".¹

MINIMUM SACRIFICE

6. It was left to Edgeworth to state the doctrine of least aggregate sacrifice. It may have been suggested by Carver, whom Edgeworth quotes,² but the enunciation is clearly Edgeworth's. "Minimum sacrifice, the direct emanation of pure utilitarianism, is the sovereign principle of taxation. . . . Before leaving the principle of minimum sacrifice, let it be observed that, under the limitations which have been described, this principle may also be applied to justify differential taxation on the ground of differences in other respects besides size of income: for instance, difference in the permanence of the income, differences in civil state, number of children, age, and other attributes".³ Thus, if it be assumed on the law of Bernouilli that utility diminishes in inverse ratio to means, the principle of equal sacrifice leads to proportional taxation, of proportional sacrifice to progressive taxation, while the principle of minimum sacrifice to a fairly high level of exemption, combined with a somewhat

¹ J. S. Mill, Book V. chap. ii. sect. 2, para. 1. Cf. *Economic Journal*, vol. vii., 1897, p. 564.

² "The minimum amount of repression (or check to the growth of wealth) is secured by imposing an equal sacrifice on all members of the community, but the minimum amount of sacrifice is secured by collecting the whole tax from those few incomes which have the lowest final utility. No rational writer advocates the latter plan exclusively, but many rational writers do advocate the former plan. Yet it is not beyond dispute that the former plan ought to be followed exclusively" (T. N. Carver, "The Ethical Basis of Distribution", *Annals of the American Academy*, 1895, p. 97).

³ *Economic Journal*, vol. vii., 1897, p. 556.

steeply progressive taxation of those whose incomes are taxed. Strictly speaking, the principle of equal sacrifice and proportional sacrifice (unlike that of minimum sacrifice) make all members of the State pay something. It is indeed an ideal of taxation when all classes pay their share to the State. As a rule, however, the lowest classes are called on to contribute only through the luxuries which they consume.

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PROPORTIONAL TAXATION AND THE CLASSICAL ECONOMISTS

7. It will now be convenient to determine whether the individual taxpayer should contribute in proportion to his income or more than in proportion. Both proportional and progressive taxation may be based on the criterion of ability, and both may claim to be the ideal mode of apportionment. Proportional taxation is the more conservative, and its essential basis is that the existing distribution of wealth should not be disturbed by taxation. If it is to be disturbed, other means of effecting this should be adopted, as it is not the function of the financier to solve social questions. His job is to secure revenue with the least possible discontent on the part of the taxpayer. Nineteenth-century teaching in England and France was on the whole undoubtedly in favour of the rule of proportional taxation. It was traced to Adam Smith's first canon of taxation,¹ which laid it down that the subjects ought to contribute for the purpose of defraying public services gratuitously rendered "as nearly as possible in proportion to their respective abilities". Adam Smith shows that the measure of abilities is the revenue enjoyed under the protection of the State. From this it was held that taxation should be proportionate to revenue. It is, however, unfair to deduce this from the canon. Elsewhere Adam Smith says, "It is not very unreasonable that the rich should contribute to the public expense not only in proportion to their revenues, but something more than in proportion".² The doctrine of proportional taxation which was first put forward against the privileged classes is now used against those who frankly wish for a change, however slow, in existing society. Even Bastable, writing in 1892, clings to the simple classical doctrine upheld by Mill, McCulloch, De Parieu, Hermann, and

¹ *Vide* p. 123.

² McCulloch's edition, p. 378.

other nineteenth-century writers. "The result", he writes,¹ "is that on the whole, and speaking broadly, taxation should be proportioned to revenue, by which a fair approximation to justice and a convenient basis of working are supplied." To-day such a theory is out of date and does not square with practice.

PROGRESSIVE TAXATION—ITS POPULARITY

8. Next with regard to progressive taxation. The change in financial policy during the present century in regard to progression has already been noted. The change is seen in the practical application of progression in income-tax systems, in general taxes on property, and above all in inheritance taxes. The supporters of this principle are to be found even among the precursors of Adam Smith. Montesquieu, in the famous thirteenth book of *The Spirit of the Laws*, supports it. In the four classes of citizens in Athens in the time of Solon the first paid no taxes, the second were assessed at five-ninths of their property, the third were assessed at five-sixths, and the fourth or highest class at full valuation. "The tax was just, though it was not proportional. If it did not follow the proportion of goods, it did follow the proportion of needs. It was judged that each had equal physical necessities, and that those necessities ought not to be taxed; that the useful came next, and that it ought to be taxed, but less than what was superfluous; and lastly, that the greatness of the tax on the superfluity should repress the superfluity."² The principle of progression was adopted in France in 1793 and revived in 1848.³ It is probably on this account, and the hatred of French writers such as Leroy-Beaulieu and others to socialistic tendencies, not necessarily socialism,⁴ that has produced so stout a stand against the theory in the nineteenth century. Say⁵ and

¹ Book III. chap. iii. p. 324.

² Cf. *Esprit des lois*, Book XIII. chap. vii.

³ "Before the Revolution taxation was proportional; then it was unjust. To be truly equitable, taxation must be progressive" (Decree of Provisional Government, 1848).

⁴ Cf. pp. 66-70 Seligman's *Progressive Taxation*, where Adolf Wagner's socio-political theory is criticised. It is the duty of the State financier, according to Wagner, to bring about a more equitable distribution of wealth. Cf. also Adams, *The Science of Finance*, p. 341.

⁵ "Si l'on voulait asseoir l'impôt de chaque famille de manière qu'il fût d'autant plus léger qu'il portât sur un revenu plus nécessaire, il faudrait qu'il diminuât non pas simplement proportionnellement, mais progressivement."

Garnier were exceptions to this rule, as they supported progressive taxation. The classical English economists felt that progressive taxation would arrest the expansion of industry, because the rate of progression would increase until no motive remained to the individual to expand industry. In Mill's words, "To tax the larger incomes at a higher percentage than the smaller is to lay a tax on industry and economy". Experience, in recent years, has shown that such fears have not taken place, the application of the progressive principle never having been allowed to increase to the point at which this desire to develop industry is imperilled or the accumulation of capital retarded. Again, the complexion of events has changed, especially since 1914, and the Great War forced financiers to impose such taxation, and its practicableness and productiveness, especially in inheritance and other taxes, showed that many of the objections raised to progressive taxation have proved to be theoretical and untenable.

SUMMARY

To sum up, in future years the recourse to progressive taxation will be specially marked in the chief industrial countries, and it will be none the less noticeable in the Dominions and in India where the limits of practicable progression have not yet been nearly reached. Direct taxation, as the War has shown, is far more expansive than was hitherto imagined. The broadest shoulders often do not bear a fair share of taxation. On the other hand, it has sometimes been said that progressive taxation in these countries means taxation of an arbitrary and uncertain nature. To some extent this is true, but this is often overstated.¹ It is, however, not more arbitrary than, say, the proportion of direct to indirect taxes. We have already dealt with the arguments that this form of taxation will lead to the checking of the accumulation of capital, and even to the export of capital. The question of productiveness in some countries, especially as a result of war-time experience, has been a matter of fact, and the growth in the popularity of progressive taxation with finance ministers and their departments tends to show that this form of taxation will become still more popular. There is, of course, the

¹ Its arbitrariness is emphasised by French economists, notably by Leroy-Beaulieu (i. 148), *L'impôt progressif et l'impôt proportionnel*.

danger of evasion, and this can be overcome mainly by administrative measures. Evasion is, however, common to proportional taxation. At the same time, with high rates of taxation the tendency to concealment is increased. Drastic penalties are necessary for the making, or assisting in making, of false returns, and it may be necessary to give power to the collecting authorities to call for the production of books, accounts, and similar documents. Auditors, if required, should be obliged to state the nature and extent of their audits. Unless the machinery for compelling the production of books and documents is adequate, evasion is liable to occur fraudulently or unintentionally. The heavier the burden the sharper should be the punishment on those anti-social offenders who, whatever be the nature of the tax, enrich themselves at the expense of others. Evasion, it should be remembered, is liable to occur in all forms of direct taxation, since assessment, often difficult, is required, and this gives opportunities for evasion as it does for arbitrary official action.

PROGRESSION AND THE NATURE OF INCOME

9. Should taxes be higher according to the source of income ? Some incomes are derived from property and interest-bearing securities, while others are from salaries, wages, and profits of professions or from trade. The former class of incomes is frequently said to last for an indefinite period, and to yield as a rule a larger amount of economic welfare than the same amount of income from work. The latter class of incomes lasts for a less indefinite period, and at the latest comes to an end with the death of the salary or wage earner. But the difference in duration of the incomes is no real reason why there should be a concession in favour of earned incomes. The worker, it is sometimes said, has to debit himself with the disutility of the work itself in earning his living, and over and above this he has to put aside for a rainy day something for his family. This is, as it were, no part of his present income.¹ He is under a moral obligation to do so, and on this

¹ This, it might also be argued, will be taxed later, i.e. when it becomes part of the beneficiaries' income. If it is taxed now as well as in the future there will be double taxation of the same income. The holder of an unearned income may, however, do the same thing, and his savings may also be doubly taxed. He is not under the same stress to do so, and probably does not. The whole income passes presumably later to the heirs.

account abatements are, under certain conditions, allowed for life insurance premia. Incomes from work should be taxed at a lower rate than incomes from property if the sacrifice of the taxpayers is to be the minimum. Incomes of those who are earning their living by work are regarded even by people who have no socialistic tendencies to be on a different footing from those typical of the leisured class—unearned incomes. It is for this reason that unearned incomes are commonly taxed at a higher rate than earned incomes. A finance minister, too, realises, as the War has shown, the supreme advantage of raising the largest revenue with the least trouble and without making the income tax an instrument of oppression. Excess profits, and especially conjuncture gains,¹ are peculiarly suited for special taxation. Banks possessing a monopoly of business such as exchange business, and firms or companies making monopoly gains, are sometimes taken as examples. “Both ground-rents and the ordinary rent of land are a species of revenue which the owner in many cases enjoys without any care or attention of his own; though a part of this revenue be taken from him in order to defray the expenses of the State, no discouragement will thereby be given to any sort of industry. The annual produce of the land and labour of the society, the real wealth and revenue of the great body of the people, might be the same after such a tax as before. Ground-rents and the ordinary rent of land are, therefore, perhaps the species of revenue which can best bear to have a peculiar tax imposed upon them. Ground-rents seem, in this respect, a more proper subject of peculiar taxation than even the ordinary rent of land. The ordinary rent of land is in many cases owing, partly at least, to the attention and good management of the landlord. A very heavy tax might discourage too much this attention and good management. Ground-rents, so far as they exceed the ordinary rent of land, are altogether owing to the good government of the sovereign, which, by protecting the industry either of the whole people or of the inhabitants of some particular place, enables them to pay so much more than its real value for the ground which they build their houses upon. Nothing can be more reasonable than that a fund which owes its existence to the good government of the State should be taxed peculiarly, or should

¹ Gains which are not due to man's own efforts but are a gift of fortune. Cf. Marshall, *Principles of Economics*, p. 623.

contribute something more than the greater part of other funds towards the support of that government.”¹

THE FUTURE OF PROGRESSION

10. The twentieth century has already witnessed a large growth in democracy, and in what is often called social sympathy. The demand for greater State action in education, public health, and other social services proceeds apace. The principle of progression is almost certain in these circumstances to have a wider and wider application. As a general rule progressive taxation should, if applied on a large scale, be on the *amount* of income rather than on the kind of income. The best progressive taxes are the income tax, the inheritance tax or death duties, and general taxes on property, and it is in regard to these that the principle of progression will be applied or extended.

It is perhaps unnecessary to recall that there is an element of regression, often a considerable element, in indirect taxes owing mainly to taxes on food and drink.² The effect of these regressive taxes will, it seems, continue to be felt to an ever-increasing extent by direct progressive taxation. The steepness of this progression is, of course, dependent on the canon of economy. A finance minister may find that he is faced with the imposition of either an indirect tax on matches or salt or the imposition of a further direct tax on income, such as the super tax (which makes the income tax progressive between different classes of income tax-payers). He makes a rough estimate of the aggregate advantage of the two taxes to the community as a whole. He may or may not decide that on balance the progressive tax should be made still steeper. At any rate he follows the principle of minimum sacrifice. The redistribution of net income as a result of this heavy direct progressive taxation in some countries, such as England, and the effect on the supply of capital, will be dealt with in a later chapter.

DOUBLE TAXATION

11. The economic solidarity which binds nations together has, especially in recent years, given rise to the important and

¹ *The Wealth of Nations*, Book V. chap. ii. part ii. art. i.

² Cf. “The Taxation of the various Classes of People” (Rt. Hon. Sir Herbert Samuel), *Journal of the Royal Statistical Society*, March 1919.

interesting problem of double taxation. In the general comity of nations double taxation is far more important than has hitherto been imagined. Countries rely for their internal development more and more upon borrowings in the money markets of London and the world, and this has resulted in conflicts between different tax jurisdictions. The International Shipping Conference of 1921, for example, passed a resolution that "Whilst the shipping industry recognises its obligation to bear its full share of taxation, it is economically impossible for the individual shipowner to bear that burden in each and all of the countries to which his vessels sail. It is therefore desirable in the interests of international trade that legislation be enacted in every maritime country of the world, giving immunity from taxation in respect to the earnings of foreign shipping in all cases where similar immunity is reciprocally given." This double taxation, it is said, involves time and labour which in regard to shipping could be better employed in other ways. It is difficult to assess the earnings of a particular vessel at one of the numerous ports at which she may call in the course of her voyage. In some countries an arbitrary method is adopted of assuming that a certain percentage of the freight money received at a particular port represents profit, and, therefore, liable to taxation before port clearance is granted to the master of the vessel. Even if this is so, it is urged that it may in the shipowner's accounts have to be set off against a loss incurred on another part of the voyage, or against a loss incurred on account of other ships of the same line. No compensating allowance is given when the financial results of losses are debit balances. It is suggested that most of the difficulties would be avoided if earnings were only to be taxed in the country of ownership or registration, and that arrangements should be made for reciprocal freedom from taxation abroad in order to avoid this duplication of taxation. It is urged in this and similar cases that the present system of double taxation distributes the burden of taxation unequally, and it prevents the free flow of capital.

The difficulty of avoiding double taxation arises when the question is asked which governments should give up revenue and to what extent? Most countries follow the principle of taxing according to origin, on the principle, perhaps, that taxes seem to be paid by things rather than by persons. The origin or *situs* is looked on as the main principle, and residence as a purely

secondary principle. Governments are more inclined to give up the principle of residence than the principle of origin, although origin is frequently dropped when new investments are made by governments. Thus the Dominions of Australia and New Zealand and Brazil have offered their securities yielding fixed rates of interest free from all taxation, present or future. During the War the United Kingdom offered its War securities free of all internal taxation. In short, the burden of the country's taxation was thrown back on the borrowing country.¹ The subject bristles with difficulties.

12. There are, in brief, four methods of avoiding double taxation :

- (i.) the method of exemption for income going abroad ;
- (ii.) the method of division of the tax ;
- (iii.) the method of classification and assignment of sources ;
and
- (iv.) the method of deduction for income from abroad.

The first of these methods is based on the theory that the borrowing country cannot successfully "tax the foreigner but can only shut him out". If it is followed, all non-residents are exempted from taxation imposed on income drawn from sources within the borders of the country of origin. It is held that this has the great advantage of increasing the amount of capital from abroad and the development of borrowing countries. It is indeed the principle recommended in the Report on Double Taxation submitted to the Finance Committee of the League of Nations by Professor Bruins (Holland), Professor Senator Einaudi (Italy), Professor Seligman (United States), and Sir Josiah Stamp (Great Britain), and published in April 1923. The Report recommends the reciprocal exemption of the non-residents

¹ "It would seem that when Government and powerful municipalities are borrowing and attempting to attract foreign capital, they are willing to forgo the tax on the foreigner, but that they would not be willing to do so in the case of the foreigner's money invested in general securities in trading concerns within their borders. It is only the urgency of their own claims they are prepared to recognise."—*Report of the Committee on Double Taxation* (League of Nations, E.F.S. 73, F. 19), 1923. Cf. the memorandum on double taxation by Sir Basil P. Blackett, K.C.B., with a note on the effect of double taxation upon the placing of investments abroad (League of Nations, E.F.S., May 1921). These reports on double taxation are an example of the very useful work in the cause of international financial relationship which the League of Nations is doing through its financial section.

in regard to income tax, as this would avoid the evils of double taxation. The simple fact, however, is all too easily forgotten, and nations are frequently unwilling to shape their policy by it. Countries, in short, on a comparative plane of economic equality could afford to adopt the principle that residence (and not origin) of income should be the controlling consideration in solving the problem.

In regard to the method of division of the tax subject to mutual convention a good deal may be said. Countries are, in practice, reluctant to abandon the principle of origin, and the difficulty may best be solved in these circumstances by a system of exemption on settled lines. The Royal Commission on the Income Tax conferred in 1920 with representatives of the Dominions and of India on the question of double taxation within the Empire. The principle was accepted that where income tax is charged on the same income both in the United Kingdom and in a Dominion or India, the total relief to be given should be equivalent to the tax at the lower of the two rates of tax imposed. In paragraph 70 of the Report¹ the settlement suggested is as follows :

Firstly, that in respect of income taxed both in the United Kingdom and in a Dominion, in substitution for the existing partial reliefs there should be deducted from the appropriate rate of the United Kingdom Income Tax (including Super-tax) the whole of the rate of the Dominion Income Tax charged in respect of the same income, subject to the limitation that in no case should the maximum rate of relief given by the United Kingdom exceed one-half of the rate of the United Kingdom Income Tax (including Super-tax) to which the individual taxpayer might be liable ; and

Secondly, that any further relief necessary in order to confer on the taxpayer relief amounting in all to the lower of the two taxes (United Kingdom and Dominion), should be given by the Dominion concerned.

The Commission felt that, if their recommendation was adopted, " the British Government will have acted generously, and that the Governments of the various Dominions will afford to the taxpayer any balance of the total relief which is necessary in order to ensure that no person shall pay in all at a rate of tax in excess of the higher of the two rates (United Kingdom and

¹ Cmd. 615, p. 16.

Dominion). The administrative difficulties of giving effect to our recommendations will be considerable, but we believe that these difficulties will be overcome. No useful purpose would, we think, be served by reviewing questions which are matters of administrative detail, and we content ourselves with indicating by a few examples the broad lines on which the proposed relief would be effected."

The Commission gives three examples which are as follows :

EXAMPLE 1.—A, a British resident, derives a fluctuating unearned income directly from a Dominion whose rate of tax applied to that income is 1s. 6d. in the £. A has no other income, and his rate of tax in the United Kingdom varies according to the amount of his income. The following figures illustrate the position :

1st Year.	United Kingdom.	Dominion.
Tax before relief . . .	£1000 at 3s. 9d.	£600 at 1s. 6d.
Relief	1000 at 1s. 6d.	Nil.
	<hr/>	<hr/>
Tax after relief . . .	£1000 at 2s. 3d.	£600 at 1s. 6d.
	<hr/>	<hr/>
2nd Year.	United Kingdom.	Dominion.
Tax before relief . . .	£300 at 3s. 0d.	£900 at 1s. 6d.
Relief	300 at 1s. 6d.	Nil.
	<hr/>	<hr/>
Tax after relief . . .	£300 at 1s. 6d.	£900 at 1s. 6d.
	<hr/>	<hr/>

In this example, although it was the same description of income assessed each year, there were wide variations in the amounts assessed in the United Kingdom and in the Dominion. This might happen owing to different methods of computing taxable profit, and the differences are intentionally exaggerated to illustrate the principles to be followed.

EXAMPLE 2.—B is a British resident receiving as shareholder an income of £900 from a British company C, which derives the whole of its income from a Dominion. In the first place relief will be given to the company C, and in order to illustrate how this is done, let it be assumed that the company's profits as calculated for the United Kingdom tax are £60,000, and as calculated for Dominion tax £50,000. Adjustment will be made to the company as follows :

	United Kingdom.	Dominion.
Tax before relief . . .	£60,000 at 6s. 0d.	£50,000 at 1s. 6d.
Relief	60,000 at 1s. 6d.	Nil.
	<hr/>	<hr/>
Tax after relief . . .	£60,000 at 4s. 6d.	£50,000 at 1s. 6d.
	<hr/>	<hr/>

The company when paying the dividend to B would deduct 4s. 6d. in the £ United Kingdom tax, and intimate on the dividend warrant that the relief in respect of Double Income Tax was 1s. 6d. in the £.

Let it be assumed that B's dividend of £900 is his total income, so that his proper rate of charge to United Kingdom Income Tax is 3s. 9d. He has suffered Dominion tax to the extent of 1s. 6d. in the £, and his ultimate rate of United Kingdom Income Tax is 2s. 3d. in the £ (3s. 9d. less 1s. 6d.), but he has suffered by deduction 4s. 6d. in the £, and he will accordingly be repaid 4s. 6d. minus 2s. 3d. = 2s. 3d. in the £ on £900.

EXAMPLE 3.—D is a British resident receiving £900 from company C, but he has other income arising in the United Kingdom, and his combined rate of Income Tax and Super-tax is 7s. 6d. in the £. He is entitled therefore to Double Income Tax relief up to a maximum of 3s. 9d., but the whole of the Dominion tax (1s. 6d. in the £) has already been allowed to the company C, who deduct 4s. 6d. United Kingdom tax on payment of the dividends, and no further relief is due. D will therefore be assessable in respect of the £900 at 1s. 6d. in the £, viz. 7s. 6d. less 4s. 6d. United Kingdom tax deducted, and 1s. 6d. Dominion tax.¹

In Section VII., paragraphs 79 to 83, the Commission considered the problem as it affected Great Britain and foreign countries, but found that the difficulty here was much greater owing to the absence of common interest, the sharing of common burdens, and the natural absence of the desire for free circulation of capital within the British Empire. The Commission concluded that "no satisfactory change from present conditions could be made unless reciprocal arrangements were effected between the Government of the United Kingdom and the Government of each foreign State where an Income Tax is in force; and that it would only be practicable to arrive at such arrangements by means of a series of conferences, possibly under the auspices of the League of Nations, such as we have been happy to hold with the representatives of the Governments of the Dominions. These considerations, among others, have led us to the conclusion that in the present circumstances we cannot recommend any change in the existing situation as to double taxation of the same income by the United Kingdom Government and by the Government of a foreign State."²

In the Finance Act of 1920 the relief proposed for double

¹ Cmd. 615, p. 17.

² Cmd. 615, p. 19.

taxation within the Empire was passed into law. This method of the division of the tax attempts to divide taxation according to the country of residence. It has the objection of placing State loans free of income tax in an obviously unsatisfactory position.

Next with regard to Method III. The method of classification and assignment of sources is best described in the words of the 1923 League of Nations Report referred to above :

By convention it might be determined to attach origin taxation specifically and wholly to particular classes of investments or embodiments of wealth, such as rents of land and of houses and mortgages on real property, but to exempt the non-resident in respect of income derived from business securities. The country of residence would allow the whole of the foreign tax as a deduction from its income tax on the resident in respect of such sources of income, but would charge other sources in full. The country of origin would retain its specific origin taxes in full. It would be necessary to give the country of residence complete power of charging all sources, except for certain specified exemptions, so that the scope of its liability to remit the tax would be easily determined, and the investor, from his total income tax demands, would be able to deduct certain specified taxes on any real property he might have. It might be desirable to impose some limit upon the power of the country of origin to levy in future specially heavy specific origin taxes, which would unduly deplete the exchequer of the country of residence.¹

The classification of wealth according to origin includes (1) land, (2) mines, oil wells, etc., commercial establishments, (3) agricultural implements, machinery, flocks and herds, (4) vessels, and (5) mortgages, while residence includes money, jewellery, furniture, etc., and mortgages on income, corporate shares, corporate bonds, public securities, general credits, and professional earnings. In short, intangible wealth except mortgages on property would be assigned to residence, while tangible would be assigned mainly or wholly to origin.

The fourth method—the method of deduction from income from abroad—is that followed by the United States. It is opposed to general practice and places the whole burden of increased taxation in borrowing countries upon the creditor country. In the words of the experts, “Governments need no longer make provision for making the loans free of tax to non-

¹ P. 42 of the Report.

resident investors, knowing that it will fall upon the exchequer of the creditor country. It is to be doubted whether such creditor countries as the United States, Great Britain, and the Netherlands, having regard to their interests abroad, would ever agree permanently to put their exchequers at the mercy of all the unknown increases of taxation of foreign Governments.”¹

It is now usually held that the ideal of double taxation is to exempt income going abroad. Where, however, there are great difficulties in the adoption of this course, a plan based on the classification and assignment of sources and modified by the division of the tax would appear to offer the best solution of a very difficult problem.

THE SINGLE TAX

13. No reference has been made in discussing the distribution of the burden of taxation to the single tax, which is, as its name indicates, the only tax on some one class of things in a country's revenue system. The omission has been intentional, because the single tax is outside the sphere of practical finance and is now more a question of ethics than economics. Viewed historically, it has been of advantage as a reaction against high or oppressive taxation. Adam Smith mentions Alcázar de Arriaga who propounded in 1646 the single Alcavala,² a general income tax, in his book *Nueva Declaracion de un medio universal para extinguir los tributos en Castilla*, or *New Declaration of a Universal Plan for Suppression of Taxes*. In 1671 another Spaniard, Centani, submitted to the King of Spain a memorial in which he asserted definitely that “la tierra es la verdadera y fisica hacienda” (land is the only real wealth), and insisted on the removal of indirect taxation in favour of a direct tax founded on an extensive cadastral survey. He has rightly been regarded by Cannan and others as the direct ancestor of the Physiocrats Quesnay and Turgot. Vauban, the celebrated Marshal of France, published in 1707 a book on financial reform called *La Dîme royale*, where he aimed at a proportional tax on every description of income derived from landed property and from house property, profits

¹ P. 42 of the Report.

² *The Wealth of Nations*, Book V. chap. ii. part ii. art. iv., “Taxes upon Consumable Commodities”.

arising from commerce and industry, salaries and pensions of officials, Government stocks, and also the wages of artisans and labourers. Vauban considered that 10 per cent should be the maximum, and 6.66 per cent a normal rate. On the wages of artisans and labourers a rate of 3.33 per cent only should be demanded because they are liable to bad seasons. "This was to be the Treasury's principal source of revenue subject to being doubled in case of great necessity of the State."

The single tax of the Physiocrats (*l'impôt unique*) in the words of Quesnay, the great Master of the school, was to be levied "directly on the net return (*produit net*) of land and not on wages, or on the (gross) produce, in which case it would increase the cost of production, be detrimental to trade, and destroy annually a part of the wealth of the nation".¹ The *impôt unique* was not to be rigorously applied as is sometimes thought. Mirabeau the elder, for example, was prepared to make the land tax responsible only for one-third of the revenue, the remainder being from the income tax. Turgot in his *Réflexions sur la formation et la distribution des richesses*,² like all practical financiers, saw that the Physiocrat doctrine was an ideal, as he was of opinion that the time had not arrived even for the abolition of the troublesome octroi. Henry George³ in the eighties of the nineteenth century aimed, like his great predecessors more than a century earlier, at a single tax. He was for the abolition of all taxation save that upon land values. Similarly a writer has recently proposed⁴ an annual production tax of 10 per cent or other required amount assessable upon an employer of labour and capital, the independent worker, and owner-user (*i.e.* a person who owns capital and himself uses that capital).

A single tax has great drawbacks—(1) that it will not bring sufficient into the Treasury to balance the budget; and (2)

¹ Vide *Œuvres économiques et philosophiques de F. Quesnay, fondateur du Système Physiocratique, avec une introduction et des notes par Auguste Onckeu*, Frankfort-sur-le-Main, 1888.

² A translation of this will be found in Prof. Ashley's Series of Economic Classics, New York, 1888.

³ *Progress and Poverty* (New York, 1879); *Social Problems* (New York, 1884); *The Land Question* (New York, 1888); cf. F. A. Walker, *Land and its Rent*, 1883.

⁴ Vide "The Foundation of Taxable Capacity—A New System," by P. D. Leake, F.C.A., read before the London members of the Institute of Chartered Accountants on Tuesday, April 24, 1923, published in the *Accountant* of April 28, 1923.

that it would mean a very unsatisfactory distribution, all things considered, of the burden of taxation. In other respects, too, it is not satisfactory, as, for example, it would generally be relatively difficult and expensive to collect. Multiple taxation, on the other hand, has not those drawbacks. The anomalies between persons under a single tax are corrected, and evasions more easily detected. Moreover, under a diversified scheme of direct and indirect taxation, the ability of all classes to pay is taken into account. Indirect taxes are usually, although not always, voluntary taxes in the sense that the taxpayer, who does not consume these articles, is a non-payer of taxes. The present income tax hits marginal expenditure, and is deducted at the source, and is less felt than if it were collected otherwise, *i.e.* when the taxpayer had spent most of the tax. An inheritance tax, as we shall see, on account of the large increase of personal wealth to the beneficiaries, is paid at the time when tax payments normally take a secondary place, and is a good tax all things considered. Particular taxes like the income tax and the inheritance tax are sometimes criticised because of their complexity, but this is often unavoidable, especially where multiplicity is reduced to a minimum. After all, a finance minister has to make the Government pay its way, and his mind must be locked and bolted to this result. A single tax is for this wholly impracticable, and he must needs have recourse to a multiplicity of taxes. He has, indeed, in taxation to live up to the principle of Martial's epigram, "*Principis est virtus maxima nosse suos*". Like Gladstone in his Budget speech (that took, it is said, five hours to deliver)—the speech of 1853—he has often to remove old taxes that cramp or harass trade and industry. If the finance minister comes into office after a great war or a national calamity like famine or earthquake, he has to find money for the Treasury wherever he can. But this is not all. He has to be a man who could never lose his head. As a brotherhood finance ministers are usually plain and unpretending men, gifted with indomitable wills and iron minds, tireless workers very precise in statement and with a clear grasp of detail. In the distribution of the burdens of taxation they require to possess the genius of common sense in its highest and best development.

CHAPTER XVIII

THE SHIFTING AND INCIDENCE OF TAXATION

1. "BEAUTIFUL things are hard", says the proverb, and this applies especially to a discussion of the principles of the shifting and incidence of taxation. In this chapter it is proposed to deal with the shifting and the general laws of incidence of taxes. The subject has frequently been treated with scant justice, but some writers have treated the subject with admirable impartiality and fulness.¹ It is interesting to study the general principles in view of the mistaken theories that have been propounded even by Sir Robert Giffen and Lord Avebury. Sir Robert Giffen, for example, in discussing taxes on property and profits, said that "they are the last of a heavy burden of a similar kind, and the fact that they are the last is so far a proof that they have been distributed—that if the persons who pay them suffered at one time, they have long since been compensated. Any long-continuing tax on profits tends to adjust itself, but in the case of England during the last thirty years the adjustment has been favoured by the remarkable growth of the country under the stimulus of the removal of other taxes."² Lord Avebury, in his address as President of the Royal Statistical Society on Local and Imperial Burdens before the Royal Statistical Society in 1901, similarly attempted to flirt with the theory which will be referred to later as the diffusion theory. He remarked, "However unjust may be the incidence of rates or taxes in the first instance, still, when new contracts have been made, when a new generation

¹ Notably Seligman in his book on *The Shifting and Incidence of Taxation*, Columbia University Press, New York (3rd edition, 1910).

² *Essays on Finance*, 1st series, p. 238. Cf. Avebury, "Local and Imperial Burdens", *Journal of the Royal Statistical Society*, December 1901.

has grown up, when other circumstances have adjusted themselves, time has in fact done much to redress the balance and remedy the injustice".¹ Long before this the distinguished judge Lord Mansfield, towards the end of the eighteenth century, was of a similar opinion when he said, "I hold it to be true that a tax laid in any place is like a pebble falling into and making a circle in a lake, till one circle produces and gives motion to another, and the whole circumference is agitated from the centre". With views of this sort there is a pleasant prospect of misunderstanding on this important question.

DEFINITION

2. The necessity for the definition of the terms "shifting" and "incidence" is obvious. After the impact of the tax or, as the Italians call it, "percussione", there is frequently the process by which the payer of the tax puts the payment on to some one else. This intermediate process is known as shifting or "repercussione", or sometimes "traslazione". Incidence is the ultimate result of the shifting. It is a direct money burden. Thus the problem of incidence is the analysis to determine who pays the tax, *i.e.* on whom the money burden of the tax falls or rests. The total direct money burden of any tax is the yield of the tax to the Treasury, while the total direct real burden is the effect. Thus a tax may mean a greater sacrifice of economic welfare for A than for B, B being the richer of the two. This is, however, not a question of the incidence of the tax but of the direct real burden. Similarly the indirect real burden is the indirect effect of the tax. Owing to the imposition of the tax, say on salt or sugar, a less amount may be consumed and the family may have to make a sacrifice of well-being. This is a question of the indirect real burden of the tax. The indirect money burden takes place when the dealer is out of pocket to the extent of the interest on the amount paid to the State as tax before he can recoup himself from the sale of the products taxed. Here again this is not a question of the incidence of the tax but of the indirect money burden of the tax. A tax may be shifted forward from the producer upon whom the tax is assessed to the consumer or purchaser. It may also be shifted backwards from the consumer to the producer when the tax is imposed in the first instance on the

* 1 P. 565, *Royal Statistical Journal*, 1901.

consumer or the purchaser. Its incidence is diffused when it affects more than two parties. The theory of the "capitalisation" or, as it is sometimes called, the "amortisation" of taxation must not be confused with the shifting of taxation. The purchaser of securities which are taxed may discount the value of the securities by capitalisation of the tax in order to escape it. In other words, taxes on land and securities which are more or less permanent sources of income reduce the selling value of the object taxed when they are first imposed. Subsequent buyers, however, do not have the burden transferred to them because they buy with a knowledge of what the tax is. They are said to reduce the price which they will pay. If, however, the tax were repealed the holders of the thing taxed would be the gainers through an increase in the selling value of the thing taxed as well as an increase in the income derived from it. The incidence, accordingly, of the tax would be on them. The "effects" of taxation may be defined as the economic effects produced by the tax. It is possible to separate "incidence" from the more general question of the "effects".

EARLY THEORIES

3. Modern financial theory in regard to the shifting and incidence of taxation need not go much further back than the Physiocrats, who held that all taxation, except that on rent, was necessarily shifted. This rigorous theory is, at first glance, a complete one, but there are certain very general assumptions; for example, wages are held to be at the minimum of existence and taxes on profits drive capital away from industry. The doctrine already referred to is most completely stated in Quesnay, who holds that taxes should be imposed directly on the net produce of land because it is always paid by the land. It should be, therefore, levied proportional to net produce and directly on this source. Quesnay also emphasises what appears to him to be the evil results of indirect taxes, and he concludes that the land-owners pay the whole of the indirect taxes levied on the goods they consume as well as on their employees. The teaching of the Physiocrats had naturally a considerable influence on Adam Smith, and through him on the thought of various countries in regard to the incidence of taxation. It was through the author of

The Wealth of Nations that the fundamental doctrine of the *produit net* was refuted.

ADAM SMITH

4. Adam Smith held that every tax must be paid finally from one or other of the three different sources of income or revenue, namely rent, profits, and wages, or from all of them indifferently. This classification, the classification of the classical economists, is open to the objection that it is apt to lose sight of the fact that all taxes are ultimately paid by persons although nominally charged on things, and persons receive their incomes frequently from more than one of these. The ultimate source of income is not necessarily revenue or capital or the collective wealth of the country. Taxes on land where proportional to rent or to gross produce are, in his opinion, on rent, and these are finally paid by the landlord. In the words of Adam Smith himself, "the more he is obliged to pay in the way of taxes the less he can afford to pay in the way of rent".¹ The landlord, in short, bears the brunt of the taxes finally where they are his own burdens or shifted on to him from various quarters. A house tax falls partly on the landlord and partly on the occupier. The proportion in which the tax falls on the owner and on the occupier is not very easy to ascertain. Taxes on wages are transferred partly to the consumer in higher prices and partly to the landlord in lower rents. They are always shifted. Taxes on necessities of consumption tend to increase wages, and, like direct taxes on wages, are passed on to the consumer or the landlord. The employer increases his sale price in order to meet his larger wages bill if there is a tax on wages, or the farmer, who likewise must have his profit, gives to the landlord less produce as rent. The capitalist has to pay his share. Taxes on wages, profits, and necessities are always shifted. Taxes on interest are not shifted, nor are those on land and on luxuries. Landowners, rich consumers, and to some extent lenders of capital are those who bear all taxes.

RICARDO

5. Ricardo in his *Principles of Political Economy and Taxation* (1817) devoted considerable attention to the question

¹ Book V. chap. ii.

of incidence. The unattractive nature of his writings was against him, but his interpreter, Mill, showed how valuable were the acute analysis and magnificent power of isolating phenomena in such discussions. His wonderful abstractions have sometimes been taken not as hypothetical cases but as real cases. He does not propound separately any general theory of incidence. Briefly his views are that a tax on economic rent is not transferable. It falls wholly on the landlord, because the rent being the surplus over the cost of production, a change in price of the produce cannot be affected by the tax. Taxes on produce or land taxes are shifted by the landlord to the consumers, unlike the taxes on pure rent. There is, however, one class of consumers who will not pay, and those are the labourers. A tax on wages is transferred to the employer of labour or the capitalist. A tax on profits is in general not transferable. It remains with the capitalist, but a tax on particular profits, *i.e.* of a particular employer, could be transferred to the consumers of the product.

RICARDO'S SUCCESSORS

6. By John Stuart Mill Ricardo's views on the incidence of taxation on wages were slightly modified. Mill points out that the higher class of wage-earners may be possibly the payers of taxes, and that the taxation therefore may or may not be shifted. Mill's great forte in taxation is to make Ricardo better understood. It was, however, left to the freshness and originality of that great Irishman Cliff-Leslie (1827-1882), the founder of the English historical school of economics, to show how Ricardo's theory failed on account of its dependence on a few unduly simplified conditions. Ricardo imagined that economic forces work like clockwork, but taxation is not so simple when notice is taken of the real limits in the application of theoretical principles. Ricardo assumed that capital and labour within a country were mobile and that self-interest was the mainspring of all action. These have only to be stated to show the weakness or incompleteness of the classical school. It is impossible to deal with abstractions without remembering that they are such. Human nature in its actual circumstances is a very different thing from fictitious nature in fictitious circumstances, and it is impossible to work out from a few first

axioms which are never quite true, and in many countries may be utterly untrue.

THE DIFFUSION OR ABSORPTION THEORY

7. That very comfortable theory, the diffusion theory of taxation, has already been referred to in connection with the names of Mansfield and Avebury. This theory is in contrast to the theories which aim at investigating the complicated shiftings that settle the ultimate incidence. It denies the possibility of ascertaining these shiftings, or it assumes that these shiftings bring about a general diffusion of taxation over the whole of society, equitably or inequitably. In other words, the individuals from whom the tax is collected do not ultimately bear the burden but shift it on to other classes so that it is diffused over a broad area. The diffusion is effected by exchange, buyer and seller in each transaction dividing the amount of tax imposed, and at every fresh exchange a division of the part of taxation transferred takes place, until ultimately the charge is spread over the whole of the parties concerned. By far the best exponent of this theory is the author¹ of *An Enquiry into the Principles of Taxation, chiefly applicable to Articles of Immediate Consumption*. It was published in London in 1790, and Seligman rightly holds that it is "perhaps the most interesting and original exposition of the doctrine". The writer, although supporting this theory, has many very sound ideas as to the shortcomings of incidence as detailed by Adam Smith and his contemporaries. He points out that economic progress provides a fund for the payment of taxes, and it is from this surplus derived from the improvement of society that taxes are paid. In his own words, "it is rather the improvement and the thriving situation of the society at large that may be said to sustain the taxes than the individuals who merely pay

¹ Seligman appears to be quite wrong in attributing the authorship of this work to Andrew Hamilton, a professor at Aberdeen. Seligman has evidently been misled by the *Bibliotheca Britannica* (1824), by Robert Watt and the *Dictionary of Anonymous and Pseudonymous Literature of Great Britain* (1882), by Samuel Halkett and John Laing. The ancient University of Aberdeen never had a professor of that name. The work appeared anonymously just about the time when Robert Hamilton (1743-1829), Professor at Aberdeen University (1799-1829), the author of the *Enquiry concerning the Rise and Progress, Reduction and Present State, and the Management of the National Debt*, 1813), was writing on such subjects.

them". He further holds that "taxes will become lighter in proportion to the number of hands through which they pass in a thriving society. . . . In order to show that improvements furnish funds for taxes it is not necessary that we should be able accurately to trace the manner in which improvements insinuate themselves through society ; nor how a tax is diffused among the various classes of citizens." He concludes that "in stationary and declining societies, taxes on consumption fall universally on all ranks ; and in thriving societies attach themselves to those citizens who are unprosperous at the time". Although the author limits the theory to taxes on consumable commodities, his reasoning, as Seligman points out, is equally applicable to other forms of taxes. Seligman rightly sums up the work as "a very remarkable contribution which ought not to have suffered oblivion". In the classification of all taxes he is also ahead of his time.

It is to Canard (1750-1833), whose book was published¹ in 1802, that the diffusion theory is in many ways best ascribed. He cannot, however, be called the founder of the theory any more than Hamilton. He held that the net product was applicable to labour, commerce, as well as land, and therefore taxation falls on all three, and he compares taxation of any one branch to the operation of cupping. After the taking of the blood from the vein it is not more bloodless than any of the other veins of the body, so he believes it is with profits which are not diminished by a tax. The profits of all other branches flow in at once until the equilibrium² is restored, and finally the tax is borne by all. He believes that every old tax is good ; every new tax is bad, as it upsets or deranges the equilibrium, but the new tax becomes good in time provided it is continuous sufficiently long. His solution of the problem is to replace all existing taxes by a tax on salt.

To sum up, the diffusion or, as it is sometimes called, the absorption theory denies the possibility of ascertaining the shifting and incidence of taxation, and it assumes that this brings about a diffusion of the burden throughout the social whole. Few will agree with Stein that taxation is always part of the cost of production, and that it therefore enters into price with the

¹ *Principes d'économie politique.*

² Cf. also the remarks of Alexander Hamilton in the *Federalist*, where he compares taxes on consumable articles to a fluid which will in time find its level.

result that it is diffused throughout the community. Taxes on profits, interest, and wages are not always a part of production. It cannot be logically supported and it is also contrary to experience. The diffusion or absorption theory, however, although it is contrary to the world of actual fact, and although it attempts to prove more than it can, has been of considerable advantage, because it emphasises the fact that taxes do not rest where they are assessed. That is its one main redeeming feature. It rests, as Walker said, upon the assumption of perfect competition, but perfect competition cannot exist where there are ignorance, inertia, poverty, and fear in a community. The wealth of society from which taxes are paid cannot be compared to a fluid or to cupping, but should be compared, as Say rightly said, to a tree or the body, no part of which can be cut out without disfigurement. The theory presents a strong contrast to that of the classical school, which realised the importance of looking into and examining in detail the "seating" of taxation, with the object of effecting legislation on conclusions arrived at in regard to the equitable distribution of taxation. The "diffusion" or "absorption" theory of incidence is a useless theory. Taxes indeed are often widely diffused. But it is nevertheless quite possible to reach definite results regarding their incidence.

GENERAL PRINCIPLES

8. The incidence then of the various kinds of taxation is clearly one of the most difficult problems in the science of finance. The argument, at first sight somewhat specious, that taxes are diffused or absorbed until the burden of the tax or taxes cannot be determined and that nobody's burden is probably heavier than any one else's, is far from sound. As has been emphasised, many taxes are, as a matter of fact, diffused, but it is certainly possible to reach definite conclusions as to their shifting and incidence and economic results. The view that taxes fall on everybody assumes that all taxes enter into the cost of production, an untrue assumption obvious to any one who considers that taxes are levied on persons in cases where there is no idea of the relation of producer and consumer. Earlier in this chapter we have distinguished between the impact of a tax and its incidence. The original persons who pay the tax feel the impact of that

tax; the persons who bear the direct money burden, or what may be said to be the equivalent of the yield of tax to the Treasury, are those on whom the incidence falls. The incidence may or may not be the same as the impact. It is, perhaps, unnecessary to repeat that taxes are paid by persons and not by goods or things. The amount of the tax is usually connected with goods or things and the relation of the person to these. In the case of houses, for example, the tax is fixed according to the capital or the annual value of the house. The property merely measures the amount of the tax which is levied on persons whose relation to the property is that of owner. A thermometer measures heat: so with taxation—taxes are placed often on things, but that is merely for the sake of measurement. They are paid by persons, not by things. Some taxes are paid by those who feel the impact. They are direct taxes, *e.g.* on income, inheritances, and certain taxes on monopolies, while others are passed on to others indirectly, *e.g.* taxes on imports, excise duties, and the gross receipts of limited companies. In practice it is usually assumed that a tax on a commodity is always an indirect tax. If the tax, when levied, results in no rise in the price of the commodity if collected from the producers, it is in reality a direct tax. If collected from the consumers and the price is decreased to the full extent of the tax, it is also a direct tax. Similarly, an income tax may result in a rise in the rate of interest in the long run, because it produces a reduction in saving; those who are investing new savings in concerns at the higher rate have really shifted part of the incidence of the tax on to the shoulders of those who are demanding new concerns. A tax, it is often pointed out, which is proportionate to the output of a monopoly may be an indirect tax, while a tax independent of the output of the monopoly may be really direct.

THE USE OF STATISTICS IN INCIDENCE

9. A caveat is necessary here in regard to the use of statistics in dealing with questions of incidence. The effect of a tax on a commodity is often of small importance in its price as compared with changes in other factors. The tax may be, in short, only a small factor as compared with other factors determining the price. In March 1923 the salt duty in India was doubled, and

the actual increase in the duty was one rupee four annas per maund of 82½ lb. In August 1923 the increase in the price of salt as compared with February 1923 was more than the extent of the tax in various centres, and as compared with August of the previous year was less than the extent of the tax except in Madras, Allahabad, and Lahore. There are, however, other factors to be considered in dealing with the rise of salt prices besides the increase in the duty. Prices rose as they ordinarily do during the monsoon. On an average of five years it is found that in Bombay the price of salt is higher during the period June to November than in other months, as the tendency is to take delivery of as little salt as possible during the monsoon period, when the salt deteriorates quickly through moisture. In many markets the retail prices of salt had not increased by the extent of the duty, and there were other factors at work. The incidence of a tax on a commodity cannot be determined merely by a comparison of the prices before and after the imposition of the tax either in the same country or between different countries. The greatest care is required in making deductions on incidence from price statistics, because the tax is only one factor, and often a small factor, which produces the change in prices. Incidence is, of course, a price question, and part of the wider theory of value.

THE INCIDENCE OF TAXES ON COMMODITIES

10. Where there is complete mobility of capital and labour and no economic friction, the taxation of commodities, other things being equal, will be shifted from producers to consumers. Checks on mobility impede the shifting of taxes. A modern writer¹ sums up the governing conditions as follows: "(1) the presence or absence of mobility: in the former case the normal shifting to the consumer will take place, in the latter it is retarded; (2) the law of demand for the particular commodity: on this depends very much the extent to which there will be a reflection of the burden either back to the producer or to other industries; (3) the presence or absence of monopoly; (4) the method of taxation as affecting the preceding conditions; (5) the organisation of the industry and its division; and (6) the

¹ Bastable, Book iii. chap. v. p. 376. Cf. Seligman, *Shifting and Incidence of Taxation*, Part ii. chap. i. p. 221.

amount of taxation". If, as usually happens, as a direct result of the tax the price rises to the full amount of the tax, the incidence will be wholly on the consumer, and if the price does not rise at all, wholly on the producer or seller. If the price rises by less than the full amount of the tax, it will fall partly on the consumer and partly on the producer. The more elastic the demand for the article taxed, the more, other things being equal, will the incidence of the tax be on the producer, while the more elastic the supply, the more, other things being equal, will the incidence of the tax be upon the consumer. In other words, the incidence of the tax (or its direct money burden) will be divided between the consumers and the producers according to the proportion of the elasticity of supply to the elasticity of the demand for the article taxed. The more elastic the demand, the more will it tend to fall off on account of the rise in price as a result of the tax. The producers will be unable to shift the whole burden of the tax to the consumers. The more inelastic the demand (*e.g.* for necessities), the more will a tax on these raise their price as compared with an equal tax on luxuries. A tax on necessities passes on with less friction to the consumer than if the commodity was of the intermediate class of goods which are easily affected by a movement in price. The more elastic the supply, the more will supply fall off, and the less will consumers resist the rise in price. Speaking generally, we may say that producers shift as far as possible the tax on to consumers by reducing the supply, and consumers shift the tax on to the producers by reducing their demand. The success of either party depends on their relative strength to carry this out with the least loss. Where producers have formed monopolist combinations this raises further issues, as will be described below. Some taxes are shifted more easily than others, *e.g.* a tax on salt or sugar is shifted more quickly than a tax on houses, where a lease prevents during its currency any alteration to the detriment of the tenant. Not a few writers on the incidence of taxes on commodities argue that on the doctrine of average profits resulting from the effective mobility of capital all taxes on commodities are shifted from the producers to the consumers. It is held that the effect of the tax on any article is to reduce below the "normal level" of profits elsewhere the profits obtained from its production. Accordingly, production will be restricted

and the price raised until again producers are making "normal profits". When this point is reached the *status quo* will have been attained, and the tax will have been shifted to consumers. This theory takes no account of differences in the elasticity of demand for commodities. If one article for which the demand is elastic is taxed equally with another, the demand for which is less elastic, the price of the former after the imposition of the tax will ordinarily have been less than in the latter case. In other words, the consumers in the former will bear a less part of the incidence of the tax than in the latter. Another objection to the theory is that in the practical sphere of finance the doctrine of average profits does not square with facts. Mobility is nothing like so great as is assumed.

MODIFICATION OF THE THEORY OF INCIDENCE IN REGARD TO MONOPOLIES

11. The taxation of monopolies requires separate examination. The monopolist differs from the producer under competitive conditions since he controls supply. The incidence of the tax in these circumstances will vary according to the nature of the tax. A tax on a monopoly will tend to reduce, *ceteris paribus*, the net receipts of the monopolist. A tax will increase cost of production, but whether the monopolist or the consumers will bear the tax or part of it depends on the supply of and demand for the monopoly. The monopolist may be supposed to fix the price at a point that will yield the largest net return, and production will be limited to that amount which will produce this maximum monopoly revenue. The monopolist secures, indeed, maximum monopoly profits. There are three cases: (1) where the tax is proportionate to output; (2) where the tax is independent of output; and (3) where the tax diminishes as output increases.¹

In the first of these instances (*i.e.* where the total amount of the tax is proportionate to the volume or quantity of the output) the incidence of the tax will be as follows. The tax will raise the

¹ The taxation of monopolies is dealt with by Marshall, *Principles of Economics*, Book v. chap. xiv. S. 4 (pp. 480 ff.). Cf. Edgeworth's articles on the "Pure Theory of Taxation," *Economic Journal*, vol. vii., 1897. A. W. Flux's *Economic Principles* contains an excellent appendix on the diagrammatic treatment of the subject.

price of the article to the consumer to some extent except, of course, in the rare instances where supply is absolutely inelastic or demand absolutely elastic. *Ceteris paribus*, the rise in price will be greater the less elastic the demand (*e.g.* sewing thread) and the more elastic the supply. In the second of these cases (*i.e.* where the tax is not proportionate to the quantity produced) the tax will not affect the price to the consumer, and the incidence, therefore, of the tax will be on the monopolist. The State would in such instances levy a fixed sum annually on the monopolist, or a sum proportionate to the net profits. This would be like a tax on rent, incapable of being shifted. Lastly, where the total amount of the tax diminishes with the increase in output, this would lead, in certain circumstances, to an increase in output and to a lower price for the article produced. The monopolist would bear the tax entirely and shift part of his monopoly gains to the consumer by way of lower prices. In practice, however, perfect monopoly does not ordinarily exist, and the monopolist does not always charge the full monopoly price. Hence he may sometimes shift the tax on to the consumer by "tightening up" monopoly power when new taxation is imposed. Similarly, producers smarting under heavy and new taxation may, as in Great Britain in recent years, combine, and as monopolists extract from the consumer higher prices for their production.

TAXES ON INTERNATIONAL TRADE

12. Taxes on imports are usually shifted, and shifted intentionally, to the consumer. They bring into the market a competitive untaxed supply, and the imported article usually rises in price to the full extent of the duty. The ultimate effect, as compared with the immediate effect, of the import duty may be a fall in price owing to the fostering of infant industries. We are, however, not concerned here with the arguments for or against protection, but with the shifting and incidence of these taxes. If import duties are levied for revenue purposes only, they should be accompanied by internal taxes, such as excise duties, at the same rate on the same goods. It is well to remember that import duties are frankly tempting to a finance minister, because the effect of such taxes is often only slightly seen and understood, and they are a convenient method of getting revenue. When

shifted to consumers, these taxes (*e.g.* those on necessities, such as sugar, clothing, etc.) are apt to impose on the poorer classes a disproportionate share because their expenditures on these are much larger in proportion to their incomes than in the case of the rich.

The remarks on the taxation of commodities in internal trade apply also to custom duties on imports and exports. Take, for example, the demand by producers of iron and steel in India in 1923 for a heavy import duty on steel of $33\frac{1}{2}$ per cent. Manufacturers of cotton piece-goods in some centres in India would like to see a duty similar to the duties imposed in the United States on goods entering for consumption—a duty in the neighbourhood of 44 per cent. What would be the effect of the tax on the consumer? Who would really pay the tax?

If there were no increase in prices as a result of the tax, the whole incidence would be on the foreign manufacturer or the foreign merchant. The producer abroad, when a heavy duty has been imposed, will not send his products unless the importer pays the tax, or unless more advantageous markets in other countries cannot be obtained. The sale of the commodity may be pushed in other markets where the sales may increase. A reduction amounting to less than the duty levied in these other markets might make it possible to continue without so great a loss as the new duty entails on what hitherto went to the protected market. The reduction in imports into the latter market might even raise prices to a point, other things being equal, at which it would not pay to divert to other markets. The rise in prices will check the demand in the protected market, and this reacts on production. If the price rose by something less than the duty the tax would be divided between the producer abroad and the consumer in the protected market.

If the taxing country has been in the habit of taking a large part of the foreign producer's supply, as in the case of India's consumption of English cotton piece-goods, that producer may be compelled to bear part of the tax to lessen his loss. If the producer has more or less a monopoly or produces the goods according to the law of diminishing returns, the price will not rise to the full extent of the tax. The monopolist may sometimes bear the tax by selling the commodity at the same price, but at the old price he may give less quality or even smaller measure. But

it is rarely the case that a country has a complete monopoly and rarer still for foreign producers to combine completely to obtain monopoly prices. If the demand for the article is relatively small, if its supply can readily be adjusted, and if other free markets are available to the manufacturer abroad, the whole tax will fall on the consumer, and the price, owing to other causes, may even rise more than the tax. The remarks on the elasticity of demand and supply in paragraph 10 are of importance in this connection.

Next, with regard to export duties. In international trade export duties are as a rule unpopular because they are the converse of an export bounty and put the home exporter at a disadvantage. Import duties, on the other hand, are increasingly popular because they ostensibly help the home producer and are conveniently collected at the port of entry or at the land frontier. The foreign consumer may be asked to pay the export duty, but his doing so in whole or in part depends on his ability to go without the export. He may have the means of obtaining a similar class of article elsewhere. If his demand is inelastic, and he must have the commodity, he will ordinarily pay the whole of the tax. The more sharply the demand is checked by a rise of price as a result of the duty, the less easy will it be to shift the tax to the consumer abroad. If the duty is so high as to render exports impossible, the prices of that commodity may at first fall in the internal market. If this lasts for long, production will be affected. With poor prices quality, too, may deteriorate. If the duty is not high and if the quantity exported of the articles, on which the tax has been put, is relatively to production high, it is not improbable that the exporting country may for a time bear the tax to prevent a fall in the exports and internal prices of the commodity. In recent years export duties have in India and in other parts of the British Empire, for example, in some African colonies, been imposed on certain commodities. An export duty in 1917 was imposed on petrol in India primarily to prohibit consumption, for war reasons. It was, however, found to be a good tax. Similarly on cotton exported abroad from Bombay and jute from Calcutta there is a small export duty, mainly used for local purposes. It has been found that these duties are productive of revenue and for this reason they have been retained. Export duties, however, hinder export except where there is a monopoly or quasi-monopoly on the production of the article and where the

duty is very small. The object the financier has in view is revenue, and he places duties on imports and more rarely on exports where those duties are likely to fall in with the Smithian canons of certainty, convenience, and economy, and at the same time are not likely to fall very unfairly on any class or classes of the community. Adam Smith indeed reminds us that "in the arithmetic of the Customs two and two, instead of making four, make sometimes only one".¹

¹ *The Wealth of Nations*, Book V. chap. ii. part ii. art. iv. Adam Smith quotes Swift, who attributes the remark to an unnamed commissioner of Customs. "One of these gentlemen pleasantly told me that the mistake of parliaments on such occasions was owing to an error of computing two and two make four; whereas in the business of laying impositions, two and two never made more than one" (cf. p. 365, vol. ii. of Cannan's edition).

CHAPTER XIX

THE INCIDENCE OF TAXES ON THE DIFFERENT CONSTITUENTS OF INCOME

1. It is important to examine here the general principles of the incidence of taxes on the chief constituents of income—rent, interest, wages, and profits. For purposes of this discussion we shall assume that the taxes are levied separately on these forms of income, and it will be of interest to see the incidence of the taxes over rent, interest, wages, and profits, taxation being regarded as a certain loss spread over these forms of income.

Taxes on the pure rent of agricultural land cannot be shifted. These fall on the proprietors of the rent-yielding property. Since the amount of rent is not a cause of high or low prices of produce, a tax on rent is not a factor affecting that price. “Corn”, says Ricardo, “is not high because a rent is paid, but a rent is paid because corn is high.” In the second chapter of his *Principles of Political Economy and Taxation* he emphasises the fact that “rent does not and cannot enter in the least degree as a component part” of the price of corn, and adds in a footnote, “The clearly understanding of this principle is, I am persuaded, of the utmost importance to the science of political economy”.¹ In chapter x. on “Taxes on Rent” he begins by saying that “A tax on rent would affect rent only; it would fall wholly on landlords, and could not be shifted to any class of consumers. The landlord could not raise his rent, because he would leave unaltered the difference between the produce obtained from the least productive land in cultivation, and that obtained from land of every other quality”.² A tax does not affect that particular land

¹ Gonner's edition of Ricardo's *Works* (Bell & Sons), p. 55.

² *Ibid.* p. 154. The *locus classicus* on the Ricardian Theory of Rent is Marshall's *Principles of Economics*, Book V. chap. ix. ff. Hadley in his

which pays no rent, and, therefore, leaves the total amount of rent including the tax as it was. Suppose Government levies a 5 per cent tax on the rent. This will affect neither the total amount of rent nor the supply of the commodity. The supply of the commodity is already fixed to yield a higher aggregate rent than either a less or greater supply would yield. In other words, 95 per cent of the rent is also greater for that supply than for any other scale of supply. The incidence, then, of this 5 per cent tax will be on the proprietors who, while the total rent yielded is the same, receive 95 per cent, or 5 per cent less than hitherto. Were the tax repealed the proprietors of the rent-yielding property would secure a direct money benefit in an increase of income. The incidence of the tax, therefore, is plainly on them.

The argument assumes that the receivers of rent are obtaining the highest possible rents from the land. Where the full economic rent is not obtained, the new tax may result in practice in an increase of rents, and in such instances part of the incidence will be on the tenant or occupier. In all discussions on the incidence of a tax on rent it should be remembered that pure economic rent of agricultural land is not infrequently mixed up with forms of income due to capital and labour, and is not confined to the natural qualities of the soil; actual rent, in short, contains an element of profits.¹ In Great Britain and similar countries, when the land tax is permanently fixed or of long standing, the tax is "burdenless". The person who purchases the land allows for the tax, paying for the land a price based on the net return after deducting the tax. The first owner pays the burden. Through ignorance or carelessness the landlord may let a tenant have the land for less than might be got by the sharpest bargaining. In a country like England, agricultural land is owned and managed for the satisfaction of social ambition as well as for immediate pecuniary return, and is not infrequently let to farmers on indulgent terms. Under such circumstances an additional tax

Economics warns his readers that "The 'economic', i.e. 'Ricardian' sense of the word rent must not be confounded with its ordinary commercial sense. Commercial rent represents a price paid for the use of land *and improvements*. A large part of it is interest rather than rent. If we deduct the interest on improvements from the commercial rent, the remainder is economic rent" (p. 287).

¹ Rent in practice consists not only of pure economic rent, but also of some return to capital invested in or on the land.

levied on the landholder will probably lead him to look sharply at his rentals.

The incidence on any other form of pure rent falls on the person who pays the tax. This is certainly so in the case of rent of ability.

TAXES ON BUILDING RENTS

Adam Smith and Ricardo each analysed separately the incidence of taxes on houses.¹ Adam Smith divides the rent of a house into building and ground rents. "The building rent is the interest or profit of the capital expended in building the house. In order to put the trade of a builder upon a level with other trades, it is necessary that this rent should be sufficient first to pay the same interest which he would have got for his capital, if he had lent it upon good security ; and, secondly, to keep the house in constant repair, or, what comes to the same thing, to replace within a certain term of years the capital which had been employed in building it." A tax on the rent of houses may fall on the occupier or on the ground landlord or on the building landlord. Ordinarily the tax would be paid "immediately and finally", as Ricardo phrases it, by the occupier. Ricardo dissents from Adam Smith's view that ground rents and the ordinary rent of land are "the species of revenue which can best bear to have a peculiar tax imposed upon them", believing "it would surely be very unjust to tax exclusively the revenue of any particular class of a community". He shows that such taxation is contrary to one of the four Smithian maxims which should govern all taxation.

The transfer of the burden is not so easy a matter as in the case of goods readily marketable. It may fall on the owner, the occupier, and also the builder. When taxes on buildings and on the gross rent of the house are levied on the occupier, the incidence usually is on the occupier and not on the owner. There is, however, considerable friction, and the readjustment of burdens takes place slowly. If the occupier desires to shift the burden to the owner, a new lease has usually to be made. He

¹ Cf. *The Wealth of Nations*, Book V. chap. ii. part ii. art. i., "Taxes upon the Rent of Houses." Ricardo, *Principles*, chap. xiv., "Taxes on Houses." Royal Commission on Local Taxation, Cd. 638, London, 1901 ; and C9528 (1899), which contain the memoranda of various authorities.

may, however, prefer to remain where he is and bear the tax, as the expense of removing and the convenience of his present house may compel him to remain where he lives. If he does remove he will select a house, having the tax in view. He may, then, succeed in shifting the tax to his new landlord. The tendency, however, is for the tax to remain where its impact took place, at least for a considerable time. This is not necessarily always the case. The occupier, if engaged in trade such as a dry goods store, may shift part of the tax to his customers, especially when the customers are of the poorer classes and unable to make their purchases outside the locality. The demand for the goods on the part of the customers in their neighbourhood is not so elastic as when they can purchase outside the area, *e.g.* from large stores centrally situated. Before it can be said that the tax falls on the occupier or on the owner or otherwise, the elasticity or inelasticity of the supply should be examined.

If the tax be on the owners it will check the increase of the supply of rentable houses, as it will, *ceteris paribus*, reduce profits. It may also reduce the expenditure on construction, as occupiers will tend to take slightly smaller houses rather than pay the increased rent as a result of the tax. The checking of house-building in turn may check the demand for sites. The owners for the time being may pay the tax, as they cannot raise the rents during the currency of the lease, the supply of and the demand for houses remaining constant. If they sell their property, the new owners will purchase with the tax in view. These new purchasers aim at making their investments similar in yield to others with corresponding risks. Owners may find that tenants prefer to take less accommodation than pay the higher rent. Tenants may even be able to go to neighbouring districts, so that the owners may again be prevented from raising rents. After a period, however, rents may rise, and the owners may shift the taxes on to occupiers because the supply of houses may be adjusted to meet the changed circumstances. Thus it is clear that a tax on annual rental values is frequently only imperfectly readjusted, and that too only after a period of friction. The incidence, in short, may fall partly on the owner, partly on the occupier, and also on the builder. In some cases the occupier if in trade may shift part of the incidence from his shoulders to those who purchase his products. Occupiers bear a considerable

part of the incidence of the tax. Where the tax is imposed on the occupier more of it will be borne by him than when it is assessed on the owner. That experience undoubtedly proves.

THE TAXATION OF INTEREST ¹

2. In the paragraphs on double taxation we had occasion to refer to Adam Smith's remark that "the proprietor of stock is properly a citizen of the world, and is not necessarily attached to any particular country".² If there is a tax on interest, theoretically there is a tendency for the capital to be sent abroad, and this will leave, *ceteris paribus*, less capital in the taxing country. The tax will also be an impediment in regard to the accumulation of capital in two ways, viz. by affecting their *will* to save and also their *power* to save. Interest, of course, is one of the factors which determine the accumulation of capital. This reduction in the volume of capital would increase its marginal productivity, and the less productive concerns would receive scantier supplies or no supplies at all. Industry's productive power, therefore, would be decreased. The rise in marginal productivity would increase the rate of interest, and the burden of the tax in these circumstances would be transferred from the owners to the users of capital. After some time the users of capital would shift the tax to the consumers of their goods. The main part of the direct money burden would not permanently fall on the owners of capital, the receivers of interest, but it would be passed to users of capital and ultimately to consumers. If the tax on interest does not fall on the interest yield of all kinds of capital, capital will go into channels that escape taxation. Theoretically, the marginal productivity of the untaxed forms will be lowered and of the taxed forms raised by this until the net yield to the owners becomes equal. Insurance against risk or the return to risk-bearing is a part of the total return to capital, and the tendency is for a tax on risk-bearing to fall on the borrowers of capital and again ultimately on the consumers. Taxes on interest may encourage the creation of consumers' capital in the sense used by Sidgwick at the expense of trade capital, by decreasing the inducement to save.

¹ By interest is meant the return to waiting as well as the return to risk-bearing.

² *Vide* Book V. chap. ii. part ii. art. ii.

THE TAXATION OF PROFITS

3. J. S. Mill in his *Unsettled Questions*,¹ and also in his *Principles*,² treated profits as the whole of the gains of the capitalist. He indicated, what has been accepted by modern writers, including Marshall,³ that profits consist of three elements: (1) interest; (2) insurance against risk; and (3) earnings of management. Adam Smith failed, like the other earlier economists, to distinguish these elements, and it is essential in this discussion for these to be kept in mind. "The whole drugs", wrote the author of *The Wealth of Nations* in a very well-known passage, "which the best employed apothecary in a large market-town will sell in a year may not perhaps cost him above thirty or forty pounds. Though he should sell them, therefore, for three or four hundred or a thousand per cent profit, this may frequently be no more than the reasonable wages of his labour in the only way in which he can charge them, upon the price of the drugs. The greater part of the apparent profit is real wages disguised in the garb of profit. In a small seaport town a little grocer will make forty or fifty per cent upon a stock of a single hundred pounds, while a considerable wholesale merchant in the same place will scarce make eight or ten per cent upon a stock of ten thousand".⁴ When this statement of Adam Smith is considered in the light of modern teaching, especially that of Alfred Marshall and the Cambridge school, it is clear that earnings are in some respects analogous to wages. If a tax is imposed on the earnings of management, it will have the same effect as a tax on any normal return to capital or labour. It is, in other words, exactly similar to a tax on interest or wages, and its incidence will depend on elasticity of the supply of and demand for the agent of production in question.

A tax on quasi-rent⁵ is, in the short period, similar to a tax

¹ Pp. 107-109.

² Book II. chap. xv.

³ *Principles*, Book VI. chap. viii. Cf. Boehm-Bawerk, *Capital and Interest*; *The Positive Theory of Capital*, translated by Professor W. Smart. Cf. also *Supply and Demand*, by Henderson, in the Cambridge Economic Handbook Series, chap. vii., "Risk-bearing and Enterprise," especially paragraph vii.; and Stamp on "The Special Taxation of Business Profits in Relation to the Present Position of National Finance," *Economic Journal*, December 1919.

⁴ Book I. chap. x.

⁵ Quasi-rent is sometimes misunderstood and defined as the *surplus* profits secured by owners of a factor of production, say a machine or a house, when

on economic rent. Quasi-rent is the total return a machine and durable goods like houses earn when the supply is inelastic over a short period, and a tax can only be shifted forward if the supply can be quickly adjusted. In the long period, however, a tax on quasi-rent is similar to a tax on interest. The supply can be adjusted in the long period, and producers will not bear the tax. A tax on quasi-rent would reduce the inducement to invest in that particular agent of production. The tendency of quasi-rent is to diverge from interest in the short period, but in the long period to coincide with it. Thus if the quasi-rent from a house was £60 when there was no tax, and a tax were imposed of say 20 per cent, the quasi-rent obtained by the owner would then be only £48. If this is below what normally is obtained from other investments, then the owner would so contract the supply of houses whenever possible (*i.e.* over the long period) as to bring up the rate of return to the average level, or, as Pigou would say, the marginal individual net product.

THE TAXATION OF WAGES

4. With the exception of John Stuart Mill, the last of the Ricardians, the classical school of economists, with their worthy representatives abroad,¹ held that wages were generally immune from taxation. Labourers could not be taxed, as they got no more than the minimum to support themselves and their families. Taxes, therefore, imposed on labourers were shifted on to others.

that factor can only be slowly increased in quantity. This is not so. It is not a *surplus* return but the *total* return which the owner gets from an agent of production when the supply is inelastic over a short period. Quasi-rent may be a surplus or a deficit. Cf. Marshall's *Principles*, Book V., especially chapters viii. and x., and *Economics of Industry*, Appendix C, p. 426 (third edition).

¹ By "classical economists" is usually meant those economists of the first half of the nineteenth century like Ricardo, Senior, James Mill, and McCulloch, who developed the deductive and hypothetical method and treated economics as a body of doctrine immediately applicable to actual life. In Germany, Von Thunen (1780-1850) and Hermann (1795-1868) are good examples. (Von Thunen discovered the modern "marginal" theory of interest.) In France, Say, Dunoyer, and the brilliant Cournot are worthy representatives. The newer deductive school, represented by Cairnes, Bagehot, Jevons, and Marshall in England, by Bastiat, Gide, Leroy-Beaulieu, and Guyot in France, and by the Austrian school, are less dogmatic than the older school. In the text above Adam Smith is included as a classical economist. Adam Smith, however, combines deduction with induction to a degree unknown in the work of his less skilful successors.

Some held, as we shall see, that the taxes (which had the effect of raising wages) were paid by the employer out of profits, just as taxes on necessities for the same reason had to come out of the same source.

There was a sound stratum of historical truth in this theory. This history of the *esne*¹ or slave who works for hire, and of serfdom generally, shows that the incidence of the tax would in these far-off times not have been on those on whom the tax was levied. There was in addition to that historical fact the doctrine of the normal or natural rate of wages emphasised by Ricardo and Von Thunen, the latter of whom described natural wages as the square root of ap where a represents the necessities of life and p the product of capital and labour. The iron law of wages is based on the conception of a standard of living which is maintained in such a way that if earnings are increased above the amount required to secure this standard population will increase, and if earnings are decreased below this level population will decrease. Under this "iron and cruel law" a tax would be completely shifted. Lastly, the condition of the labourer in Europe in the last quarter of the eighteenth and the first half of the nineteenth century, especially after the Napoleonic wars, when wages seemed to be at the minimum of subsistence, lent further colour to the truth of this theory. Hasbach speaks of the "demoralisation of the labourer",² and Gibbins³ shows that of the increase of wealth produced by the Industrial Revolution little went into the hands of the labourers, but "went almost entirely into the hands of the great landlords and new capitalist manufacturers, or was spent in the enormous expenses of foreign war". In addition, the burden of the continental wars fell heavily upon him because "taxes had been imposed on almost every article of consumption, while at the same time the price of wheat had risen enormously. Moreover, labour was now more than ever dependent on capital, and the individual labourer was thoroughly under the heel of his employer." Wheat per quarter rose from 49s. 3d. in 1793 to 113s. 10d. in 1800, and at the same time wages were falling. In the year previous to the publication of Ricardo's

¹ Stubbs's *Constitutional History*, i. Cf. Hasbach's *History of the English Agricultural Labourer*, translated by Ruth Kenyon (London, King & Co.).

² *History of the English Agricultural Labourer*, chap. iii.

³ *Industry in England* (tenth edition), London, Methuen & Co., chap. xxiv., "The Condition of the Working Classes."

Principles of Political Economy and Taxation riots broke out everywhere in England—in Kent, for example—among agricultural labourers, in the Midlands among the miners, and at Nottingham among the artisans. With this somewhat portentous proem we may now plunge *in medias res*.

Adam Smith in the well-known chapter on “Taxes upon the Wages of Labour”¹ differentiates between the wages of ordinary labour and “the recompense of ingenious artists and of men of liberal professions”. A tax on wages must, he believed, raise wages by somewhat more than the tax. “Let us suppose, for example, that in a particular place the demand for labour and the price of provisions were such as to render ten shillings a week the ordinary wages of labour; and that a tax of one-fifth, or four shillings in the pound, was imposed upon wages. If the demand for labour and the price of provisions remained the same, it would still be necessary that the labourer should in that place earn such a subsistence as could be bought only for ten shillings a week, or that after paying the tax he should have ten shillings a week free wages. But in order to leave him such free wages after paying such a tax, the price of labour must in that place soon rise, not to twelve shillings a week only, but to twelve and sixpence; that is, in order to enable him to pay a tax of one-fifth, his wages must necessarily soon rise, not one-fifth part only, but one-fourth. Whatever was the proportion of the tax, the wages of labour must in all cases rise, not only in that proportion, but in a higher proportion. If the tax, for example, was one-tenth, the wages of labour must necessarily soon rise, not one-tenth part only, but one-eighth.” Adam Smith then holds that the rise in the wages of labour in industry would be advanced by the employers and paid by consumers owing to the rise of wages raising, as he thought, general prices; the rise in agricultural wages would, for similar reasons, be advanced by the farmers and paid by the landlords. A tax on skilled employment, *i.e.* on the earnings “of ingenious artists and of men of liberal professions”,² would be shifted, because their earnings are in “a certain pro-

¹ Book V. chap. ii. part ii. art. iii. (vol. ii. 348).

² Curiously enough, salaried officials of Government were excluded by Adam Smith, because “the emoluments of office are not, like those of trades and professions, regulated by the free competition of the market, and do not, therefore, always bear a just proportion to what the nature of the employment requires”.

portion to the emoluments of inferior trades. A tax upon this recompense, therefore, could have no other effect than to raise it somewhat higher than in proportion to the tax. If it did not rise in this manner, the ingenious arts and the liberal professions, being no longer upon a level with other trades, would be so much deserted that they would soon return to that level."

Ricardo in his *Principles*, which, it is to be remembered, is rather a series of notes than a treatise, argued that taxes on wages are paid out of profits and, therefore, that a tax on wages is in fact a tax on profits.¹ He has no difficulty in showing from the Ricardian theory of rent that all taxes paid by the farmer cannot be supposed necessarily to fall on the landlord by a deduction from rent. He demonstrates that in regard to Adam Smith's theory that a tax on wages will fall on consumers "this rise in the price of goods will again operate on wages, and the action and reaction first of wages on goods, and then of goods on wages, will be extended without any assignable limits. The arguments by which this theory is supported lead to such absurd conclusions that it may at once be seen that the principle is wholly indefensible."

John Stuart Mill in his *Principles*,² that admirable exposition of mid-nineteenth century economics, marks a great advance on Adam Smith and Ricardo in the incidence of taxes on wages. Like Adam Smith, he makes a difference between the wages of ordinary unskilled labour and the earnings of "skilled or privileged employments, whether manual or intellectual". The latter were, in fact, monopolists, and would bear the incidence of the tax. "They have", according to Mill, "no means of relieving themselves at the expense of any other class". The wages of ordinary labour depend on the standard of living to which they have been accustomed, and if this is lowered they will not increase in numbers. He disagrees with Adam Smith's view that a tax will fall on consumers because general prices will not necessarily be raised by a rise of prices, since general prices depend on other causes, and do not rise through any cause which equally affects, according to Mill, all other kinds of productive employment. A rise of wages owing to the tax, just like any other increase in the cost of labour, will be defrayed from profits. The taxation of

¹ *Principles*, chapter xvi. "Taxes on Wages."

² *Principles*, Book V. chapter iii. § 4.

these wages is, in other words, a tax on the employers of common labour, " unless the tax has the much worse effect of permanently lowering the standard of comfortable subsistence in the minds of the poorer class. We find in the preceding considerations an additional argument for the opinion already expressed, that direct taxation should stop short of the class of incomes which do not exceed what is necessary for healthful existence. These very small incomes are mostly derived from manual labour; and, as we now see, any tax imposed on these either permanently degrades the habits of the labouring class or falls on profits and burdens capitalists with an indirect tax, in addition to their share of the direct taxes."

In practice a tax on wages may or may not be shifted. If the supply of labour is inelastic and the demand elastic the tax tends to rest at the point where its impact took place. The twentieth century with its labour disputes in plenty and with its legislation for the avoidance or curtailment of such disputes shows that the assumptions that the taxation of wages will always be shifted are not always correct. Labourers may, owing to weak bargaining strength, as compared with employers, be compelled to accept a reduction in the standard of living. The history of many countries since 1920 shows this to be only too true. The employer does not always increase wages to the extent of the tax, and the labourer is unable to reimburse himself by higher wages to cover the tax. The movement of wages is not so rapid as that of prices, and even assuming wages may ultimately be shifted to profits he may have to bear the tax temporarily. The direct money burden of the tax would be entirely on the wage-earner if the lowering of his wages (*i.e.* after payment of the tax) did not impair his efficiency, and if it did not influence the number of wage-earners in the occupation or industry. Lower net wages may lead to the retirement of workmen or even, in rare cases, to commencing business on their own account. This would tend, other things being equal, to decreased production and higher costs. Profits would fall, and in this respect taxes may be shifted. If the worker's efficiency is impaired this would raise the cost of the worker's product and the consumers would have to pay more. Some share of the burden would be thrown on these classes. Workers, however, do not escape the incidence of the tax if it is thrown on con-

sumers because workers form an important part of the consuming classes. They will, therefore, bear the consumers' part of the tax which as wage-earners they shifted. If the goods are consumed by the wealthier classes these will bear part of the burden of the tax. Wages are nowadays not so close to the minimum as the older economists believed. They bear indirectly taxes on food and on other articles consumed by the labouring classes. Directly they are not taxed for the simple reason they are expensive to collect. In the higher scales of wage-earners it is doubtful, even improbable, that taxes would be shifted. Earnings here are both customary and monopolistic. There is indeed an element of quasi-rent in their earnings. They are possessors of differential gains and as such do not succeed in shifting the taxes. Adam Smith himself argued that a tax on Government officers would not raise salaries.

To sum up. The imposition of a direct tax on wages is injurious to the workman if it reduces his standard of living. Taxes levied directly on wages or on wage-earners do not ordinarily exist because they are difficult to collect and their cost of collection is high. Indirect taxes are levied on necessities for existence, conventional necessities, and luxuries, which labourers pay, usually unconsciously, in common with other consumers. The main value at the present time of discussions on the incidence of direct taxes on wages lies in the importance given to the standard of living¹ and the necessity of avoiding the taxing of the wage-earner in such a way as to encroach on the minimum. The trade depression in Europe in the triennium 1921-23 is illustrative of this, for at no period did the standard of living, or, as it is sometimes termed, the standard of comfort, receive such careful examination from taxing authorities and from Governments generally.

¹ Cf. *Report on an Enquiry into Working Class Budgets in Bombay*, by G. Findlay Shirras, published by the Government of Bombay (Government Central Press, Bombay), 1923.

CHAPTER XX

THE TAXATION OF LAND

THE general principles of taxation have now been discussed. It remains to complete this branch of the subject by an examination of the main characteristics of the various taxes, such as land taxes, income taxes, customs duties, and inheritance taxes. The present chapter deals with the taxation of land, a subject which is difficult to treat with adequate fulness and clearness.

GENERAL CHARACTERISTICS OF LAND TAXES

1. The taxation of land may be said to be almost universal. Some believe it to be the earliest of taxes, while others hold that poll taxes and the primitive hut taxes are possibly of older origin. To-day in parts of India, as in the wild hill districts of Assam, a poll tax and a hut tax are to be found, but throughout India the taxation of land is everywhere to be found. It is still one of the chief forms of taxation. Poll taxes equal in amount for all persons or assessed in an arbitrary fashion were, according to one authority,¹ unknown in England before 1377. Land taxation is to be found in a tax of the latter part of the tenth century. It is unnecessary to pause over discussions on the antiquity of land taxes. Our object is practical rather than historical.

Land taxes are an important source of revenue for central, provincial, and local authorities. These are sometimes, as in France before 1915, apportioned and not rated, the quotas being paid by authorities according to fixed shares. The usual method of levying these taxes is to make them rated or assessable on so

¹ Dowell, *History of Taxation and Taxes in England*, vol. iii. chapter i. (Longmans, Green & Co., 1884).

much per cent of the capital value of the land. This latter method is fairer, more elastic, and more suited to modern practice. The basis of land taxation may have at first been area. Thus the taxes on jugera in Rome and on the hide or hundred acres were based on this. According to some the taxation of the produce is of equal if not greater antiquity. Productivity or fertility and proximity to markets raise the question of a survey or census which the French call a *cadastre*, the object of which is to avoid inequalities of taxation. The tax may be, as we shall see, fixed for a period of years as in India. A preferable method is to fix the tax, as in Japan, on a percentage of the assessed or capital value of the land or simply on a percentage of the rent at which the land is annually let. This percentage may be varied from year to year according to the requirements of the taxing authorities, central, provincial, or local. The taxation of land for local purposes is in all countries a good source of revenue. It may be quite independent of the central or provincial governments. It may, nevertheless, be levied as an additional tax or cess. In Japan, as we shall see, an additional tax is also levied by the prefectures, cities, towns, and villages as public bodies.

LAND TAXES IN ROME

2. In the Roman Republic the land of conquered communities passed in legal theory into the ownership of the State. Revenue was raised in practice by land taxes in the form of tithes (*decumae*) or money payments (*stipendia*). In some provinces payment in kind was preferred in order that corn might be distributed free in Rome. The collection of taxes was farmed out to groups of contractors (*societates vectigales*). These rapacious tax-gatherers or *publicani* paid a fixed sum to the public authorities and squeezed as large an amount as possible from the taxpayers in the provinces. The Senate under the Republic was the authority in charge of finance, with the censors as finance ministers and the quaestors as secretaries of the Treasury. Under Augustus assessment was based on an imperial census or valuation throughout the Empire. The land tax was collected regularly, and the wasteful plan of farming this source of revenue was done away with and the tax was paid to imperial officials or to local authorities responsible to them. The rate of the tax was fixed by the

Emperor, and remissions, Tacitus¹ tells us, even in senatorial provinces rested with him. In the census or survey the area, the mode of cultivation, the out-turn of each holding was stated, the average of ten preceding years being taken as the standard. When Diocletian (A.D. 245–313) reorganised the land revenue system about the close of the third century, fifteen years (the *interdictio*²) was regarded as the period for resettlement or revaluation.

LAND TAXES IN GREAT BRITAIN

3. In Anglo-Saxon times the revenues of the kings were from their great estates, from fines, and from certain taxes to which every landowner was liable. These taxes—the *trinoda neccssitas*—were for repelling the enemy (*heregeld*), for repairing a fort, town, or public defence (*burgbote*), and for repairing or building bridges (*brig-bote*). At first these taxes were paid in kind but subsequently in money. These sources of revenue were insufficient to keep out the Danes. A special tax (*Danegeld*) was levied at so much a hide, *i.e.* about one hundred acres. The feudal aids of Norman times were mainly on land and may be regarded as a form of land tax. Restrictions were placed on these by the Magna Charta, which limited their imposition to certain important occasions, as, for example, the ransoming of the king's person, making his eldest son a knight, and the marriage of the king's eldest daughter to provide her with a dowry. These aids were subsequently known as subsidies, under which the land tax was included. In the fourteenth century we find the taxation of land referred to from time to time. Thus in 1312 the Royal Council, acting under the advice of Walter Langton, attempted unsuccessfully to levy a tallage of a tenth of rents as well as a fifteenth of movables. Later in the second quarter of the same century tallage fell into disuse when Parliament granted tenths and fifteenths—a tenth from cities, towns, and demesne, and a fifteenth from the counties outside demesne. In 1382 landowners undertook to pay the whole tax of tenths and fifteenths, but only for this occasion, “for reverence of God and for the support, aid, and relief of the poor commonalty, who appeared to

¹ *Ann.* ii. 47.

² This may have been used as early as the time of Hadrian (A.D. 117–138).

be weaker and poorer than theretofore".¹ In the following year Parliament granted two half-fifteenths and tenths levied "in the ancient manner".² During the Commonwealth period these subsidies were changed from yearly and half-yearly payments into monthly assessments. These formed the connecting link between the subsidies of the Tudor period and the annual land tax of the Revolution.³ By the Land Tax of 1797 a total sum of £1,905,077 was levied on "real estate", and in the following year this was fixed by Pitt permanently and subject to redemption. In this connexion one is apt to forget that parliamentary government in Great Britain in the seventeenth and eighteenth centuries could only mean the rule of the landed gentry. Illiteracy, except perhaps in Scotland, was disgracefully great. This class by personal interest and political zeal tightened and widened their hold upon the land while at the same time they exerted their great influence on land taxation.⁴ It is interesting to note that the fixing of the land tax permanently in Great Britain took place in the same decade as the fixing of the land revenue for all time in Bengal, parts of Bihar and Orissa, of the United Provinces and of Madras. Pitt converted the land tax into a redeemable rent charge with permission to persons interested in lands to buy up and become themselves entitled to an amount of rent charge equal to the tax. Since 1798 the amount unredeemed of the land tax has been regarded as a fixed charge on properties subject to which they are bought and sold. In England and Wales the parish is the assessment area, and in Scotland the counties and boroughs, for which quotas were fixed in 1798. The land tax does not extend to Ireland. The number of parishes in England and Wales which contributed to the tax in 1798 was 16,104; up to the 25th March 1922 the quotas of 1110 of these parishes had been extinguished. The aggregate of the unredeemed quotas in Great Britain on the 25th March 1922 was £909,136. For the year 1921-22 the net receipts after allowing for deductions were £577,490 out of a total tax revenue of approximately £853 millions or only 0.07 per cent. The maximum rate leviable is

¹ Par. Rolls, iii. 134. Cf. Dowell's *History of Taxation and Taxes in England*, vol. i. p. 116.

² *Idem*, iii. 145-46. Cf. Dowell, p. 116.

³ Dowell, pp. 81-82.

⁴ Cf. Sir W. J. Ashley, "Comparative Economic History and the English Landlord," *Economic Journal*, vol. xxiii. (1913).

1s. in the £ on the annual value of the unexonerated property as determined for income tax, Schedule A. Where this is insufficient to produce the full amount of the unredeemed quota the balance is remitted. The approximate amount remitted under this head in 1921-22 was £88,623. Total relief from land tax is granted to owners of unexonerated property whose total income does not exceed £100 per annum, and an abatement of one-half the tax is allowed to owners whose total income does not exceed £400 per annum. The approximate amounts remitted under these heads were £105,324 and £36,149 respectively in 1921-22. Crown property is not exempt from land tax, but the tax charged on such property, when occupied by the Crown for State purposes, is not collected. The amount of tax not collected under this head was £2811 for 1921-22. Any excess of tax collected over the unredeemed quota is applied as capital in the reduction of that quota. In 1921-22 £32,662 was so applied.

In addition to the land tax there are other and more important land taxes in Great Britain, viz. Schedule A and Schedule B of the income tax. Schedule A includes income from the ownership of lands, houses, buildings, and certain miscellaneous hereditaments (certain tithes, ecclesiastical dues, manorial profits, certain sporting rights, etc.). The expression "lands" includes farmhouses occupied by tenant farmers and also farm buildings. The gross assessment is the annual value or gross income, *i.e.* the rent at which the property is let or is worth to be let by the year, and certain statutory allowances or deductions are made from this to arrive at the actual income. Schedule B is profits from the occupation of lands and relates mainly to farmers' profits. The assessment, as we shall see in the chapter on income tax, is on a conventional basis which assumes that profits bear a relation to the annual value of the lands occupied. There is also the Mineral Rights duty which was first imposed in 1909-10, and the rate of duty has been 1s. in the £ on the rental value since that date of all rights to work minerals and of all mineral wayleaves. The term "minerals" does not include common clay, common brick clay, common brick earth, sand, chalk, limestone or gravel, or any substance coming within these descriptions. The person assessed is either the proprietor who works his own minerals, or the direct recipient of the rent paid by the person who is working the minerals in the

last working year. The main feature of all these taxes, with the exception of the old land tax proper, is their elasticity. They can be raised or lowered as occasion demands, being levied at so much in the £. France, as we have seen elsewhere, has converted the old direct taxes on real estate into taxes on the income from real estate, and thus obtains a greater degree of elasticity as in the English prototype.¹

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LAND TAXES IN THE DOMINIONS

4. In the nineteenth century the Dominions, the United States, and the Argentine Republic had large areas of unoccupied land. Both Canada and the United States strove to open the land freely to the people, and the result has been the system of free homestead allotments under conditions of residence and improvement. The two great dangers are land speculation and monopoly, and the crushing out of the small proprietor by capitalist agriculture or pastoralisation. The history of land policy in Australia is a case in point, and it is sometimes suggested that the probable solution of the land question there will be the compulsory repurchase by the State of land in private hands for the purpose of settling the landless small farmer. The half-acre blocks sold at public auction in Melbourne in 1837 for £1073 in all were, even thirty years ago, valued at over £5,000,000.² By the end of last century in Australasia no less than 125,000,000 acres of land had been alienated in fee simple among nearly four millions of people, companies, and individuals, by cash sales and deferred payments, while an area of 751,000,000 acres in addition had been leased to Government tenants. Of these 125,000,000 acres only 16,000,000 or 17,000,000 acres were under tillage or artificial grass. In Queensland 130,000,000 acres were owned by 45 financial institutions. In New South Wales 40,000,000 acres of the best land had been disposed of by 1884, and in 1891 the process was going on at the rate of 1,000,000 acres a year. Nearly one-half was owned by 67 companies or individuals, and large estates had been built up. This record of alienation is probably unparalleled in modern history, and it has ended in the creation of large freehold estates. The first tax on land in

¹ *Vide* Chapter XVI. p. 155, sect. 8.

² *Land Systems in Australia* (Epps), London, Swan Sonnenschein & Co., 1894.

Australia was imposed by Victoria in 1877, at the rate of $1\frac{1}{4}$ per cent of the capital value, with exemptions up to £2500. The general features of the taxation of land in Australia and New Zealand are (1) the taxation of unimproved ground values and the exemption of improvements from taxation; (2) the exemption of small landowners from taxation and the withholding of the exemption limit from companies, absentees, and large landowners; and (3) the extra taxation of absentees and companies. In South Australia, for example, absentees pay an additional 20 per cent over the usual taxes. The scale of taxation is in most instances graduated, and ranges from one halfpenny to tenpence in the £ exclusive of super-tax and additions for absenteeism. By unimproved value is meant in the Commonwealth Acts the capital sum which the fee simple of the land might be expected to realise if offered for sale on reasonable terms, assuming that improvements had not been made. Absentee in the Commonwealth legislation means a person who does not reside in Australia, or is absent therefrom when the ownership of his land is determined, or has been absent during half the year preceding that date. Under Section 51, Sub-section (ii.), of the Constitution the Commonwealth Parliament is given power to make laws in regard to taxation, but not so as to discriminate between States or parts of States. The Constitution itself gives the Commonwealth Parliament full powers of levying direct and indirect taxation.¹ Local bodies may in certain cases tax land in addition to the Commonwealth and the States. Thus several States of the Commonwealth have passed a local option law leaving it to local bodies to determine whether they should have land taxation as a system of rating for local purposes. New Zealand is often regarded as a model for land taxation. There is justification for this distinction. In 1885 the size of estates was limited for the future to 2000 acres in all. Thirty-year leases of land were also granted, with the right to perpetual renewal at re-appraised rentals. Unfortunately in 1892 leases were also given in perpetuity at a rental equal to 4 per cent on the cash price of the land. Before 1896 there was no systematic valuation of land, and the methods adopted varied in different

¹ *Official Year Book of the Commonwealth of Australia*, No. 14, p. 670. On p. 732 a convenient conspectus is given of Land Tax Acts in force in Australia, 1921 (A. J. Mullet, Government Printer, Melbourne).

places. In 1896 the confusion was ended by the creation of a State department which does the work on a uniform basis. Rating for local purposes was also authorised by the local option law of the same year. Land is assessed on its unimproved value after deducting certain exemptions on account of low value. Increased exemption on account of mortgages was abolished since 1st April 1923.¹ The scale of taxation varies from 1d. to nearly 8d. in the £, and a super-tax of 33½ per cent is also imposed. Lands not improved to the extent of £1 per acre, or equal to one-third of the unimproved value, are since April 1921 subject to a tax of 50 per cent more than the rate fixed by the annual taxing act for other land.² Income derived from mortgages of land has been since 1917 assessed under income tax instead of land tax as hitherto. Landowners are liable to income tax in addition to the land tax as in Great Britain.

In Canada there is no systematic taxation of land by the Dominion and the Provinces as in the other Dominions. The Crown lands are so great in extent that, in spite of the immigration of recent years, the Dominion Government gives a freehold of 160 acres to every *bona fide* settler, subject to certain conditions of residence and the erection of buildings during the first three years.

In South Africa land is taxed by the Union Government, local bodies, and, as in the provincial property tax of Cape Colony, sometimes by provincial governments. There is, in addition, a tax on income which includes the taxation of profits of farming and rents. In the provincial property tax of Cape Colony the value of sites, buildings, and beneficial improvements is included. By "beneficial improvements" are meant those "which increase the value of the land for agricultural purposes, and include structural works, dipping and storage tanks, kraals, fences, irrigation works, dams, boreholes, stables, etc., but not residential buildings". In south-west Africa a land tax leviable on all landed property, rural and urban, is collected in accord-

¹ Mortgaged real estate should not escape taxation by not being assessed at its full value. If not taxed, loans on real estate do not bear their fair share of taxation, and the holder of the unmortgaged real estate is more heavily taxed by having to pay a higher rate of tax than he would have had no such deductions been allowed.

² *The New Zealand Official Year Book*, thirtieth issue (1921-22), p. 416 (Government Printer, Wellington).

ance with the ordinance that obtained when the country was under German rule.

The main lessons from the history of land taxation in Great Britain and the Dominions are : (1) the desirability of a systematic system of land valuation, which should be up-to-date ; (2) the assessing of land taxation on a percentage of the capital value, which should be capable of adjustment from year to year, *i.e.* the tax should be elastic ; (3) where the tax has been, as in Great Britain, fixed permanently, there should be other means of taxing land ; this has been successfully surmounted by Schedules A and B of the British income tax system ; (4) local authorities may levy rates or taxes on land for local purposes ; and (5) the taxing of unimproved land and the extra taxation of absentees and companies, as in Australia and New Zealand, has proved to be successful.

LAND TAXATION IN INDIA

5. Land taxation in India, known usually as land revenue, is of immemorial antiquity. The question whether land revenue is rent or a tax is now usually regarded as not worth arguing. It certainly is not, except in the rarest of cases, pure rent, and, like similar imposts on land in other countries, is best classified as a tax.¹ It has all the characteristics of a tax, and its classification as rent or as a tax does not in any way affect its incidence² or its effects. There are some, however, who prefer to keep to the theory that the land revenue of India is rent. Of the value of the gross produce it forms only a small percentage, a percentage that shows a remarkably steady decrease in the last forty years. In 1881 land revenue was 6·2 per cent of the gross value of agricultural produce ; in 1898 it had fallen to 5·9 per cent ; in 1902 it was 5·9 per cent. By 1911 the percentage had fallen to 2·6, and in 1921 it was 2 per cent. In 1922 it was 1·9 per cent. In some provinces, such as Burma, Sind, Madras, and the United Provinces, the percentage was above the average, while in the Punjab, Bengal, Bihar and Orissa, and Assam, it was well below

¹ In the answer to a question in the House of Commons on 24th March 1920, land revenue was classified rightly as a direct tax. On p. 196 of the *Statistical Abstract for British India* (No. 1801 of 1923, Calcutta, Superintendent Government Printing) it is somewhat inaccurately stated, however, "Land Revenue is not properly taxation."

² Chapter XIX. p. 196. .

the average. The highest was Burma, with land revenue amounting in 1922 to 3·8 per cent of the gross produce, and the lowest Bihar and Orissa, with ·6 per cent. In the Hindu era one-sixth of the gross produce was said to be the traditional share.¹ This in Mohammedan times was one-third, in some cases much more, and it was assessed largely in cash. The proportion of land revenue to gross produce has decreased, but in estimating the actual burden other factors have to be considered, such as an increase in the cost of production and the fall in the purchasing power of money.

In taking this proportion which the tax bears to the total gross value of the agricultural produce, we should not be taken to mean that this is in any year an index of the burden of the tax, which is measured by the percentage or proportion it bears to the difference between the gross value and the cost of cultivation. One does not tax a shopkeeper on his gross receipts, and the same applies to every agent of production.

If A = the cost of production,
 B = the economic rent, and
 C = the value of the produce, then
 A + B = C.

Under cost of production there are a number of factors, viz. the price of labour (wages), the price of capital (interest), earnings of management, and the cost of materials (seed, etc.). The fact that wages have increased does not necessarily imply that the cost of production has increased at the same rate. Economic rent may increase even though the value of the produce increases less than the cost of production. It is, in other words, clear that the cost of production or one factor in the cost of production, say wages, may increase more rapidly than the price of the produce, without decreasing the economic rent in any way. Thus an increased tax on rent (or land revenue) may be quite justified, in spite of a rise in the cost of production. To put the matter in another way, the wages bill in 1911 in the Bombay Presidency for agriculture was estimated at Rs.23 crores as compared with Rs.46 crores a decade later. The value of the produce in the former year was Rs.133 crores, and in 1922

¹ "Taking from his subjects a sixth part of their riches, he should protect them all" (ch. 139, *Santi Parvan of the Mahabharata*).

Rs.208 crores. There was an increase of 100 per cent in wages, and 55 per cent in the gross produce. Wages in India at the present time are a large item in the cost of production, and we may assume that wages in the illustration above is the equivalent of the cost of production. Now

$$\begin{aligned} B &= C - A \\ &= 110 \text{ crores (1911)} \\ &= 162 \text{ crores (1922)}. \end{aligned}$$

Therefore B (*i.e.* economic rent) has increased, although the value per cent of the produce increased less than the cost per cent of production. An increase of the tax on "B" would be quite justified in these circumstances. This point has been raised because it is sometimes argued that if the cost of production increases more than the value of the produce, the State should not take more as land revenue.¹

Land revenue is a right of the ruler or the State to a share of the produce of the land, a right that has been recognised for centuries throughout India.² During the Moghul period land

¹ Mr. W. H. Moreland, C.S.I., C.I.E., formerly Director of Land Records in the United Provinces, writes with regard to the peasant's payment thus: "His payment is fixed in terms of the Producer's Surplus at the time of assessment; it very rarely, if ever, amounts to the whole Surplus, but ordinarily leaves part of it to the peasant, and this part ordinarily increases between assessments. This view is not merely true, but fruitful, because it directs attention to one of the most important questions in India, the use made by peasants of their margin. Politicians may deny that the margin exists, but it is a fact which has to be realised by students of economics. If the peasant employs the margin in (a) improving his holding, or (b) in raising his standard of life so as to increase efficiency in business, or (c) invests it outside his business, then India is laying foundations for a progressive and cumulative increase in the National Income: if he (d) hoards it, or (e) spends it on things not conducive to efficiency (particularly excessive leisure), then there is no economic justification for leaving him a margin. In point of fact the margin is distributed in all these channels. A sinks a well. B eats wheat instead of millet. C buys Savings Certificates. D buries coins in the ground. E takes to drink, or (what is far worse) sublets his land, and sets up as an Intermediary. The balance between these lines of action will go far to determine the movement of the National Income."

² Cf. the speech of the Finance Member in the Bombay Legislative Council on 15th March 1924: "It cannot be denied that the land belongs to the State and that its possession forms one of the most valuable assets from the proceeds of which the administration is carried on. The State-ownership of land is not a system introduced by the British by a stroke of the bureaucratic pen. It dates from the most ancient historical times. These assessments were based on an established and far older state of affairs, State-ownership of the land. Any payment which Government takes for the exclusive use of a portion of State property is undoubtedly in the main rent. That being so, Government

revenue was collected mainly through a system of farming, as is the case in China to-day. Akbar used an alternative system, viz. direct administration. His ideal was the payment of salaries to officials from the Treasury—the modern practice. In his time, and also to a greater degree in the time of his successors, the system of payment by assigning to the official the revenue yielded by a tract of land, a jagir, was prevalent. Akbar's land revenue was charged not on the land occupied but on the land cultivated, no payment being made for land which lay fallow. This was the system traditionally followed of taking a share of the produce of the land cultivated. During the period from Akbar to Aurangzeb the cultivator's liability to the State increased from one-third to one-half of the gross produce. The cultivator might pay more than this, as it was left to the assessor to determine the amount of land to be cultivated. About 1594 land revenue yielded Rs.860 lakhs (5·7 millions) ; on the accession of Shah Jahan it was 29 per cent higher, the increases being due partly to extended cultivation and partly to the rise in the standard of assessment.¹ Regulation II. of 1793 states that Government's share of the produce is fixed by estimating the rents paid by the tenants, deducting the cost of collection, allowing to the landlords one-eleventh of the remainder as their share, and the State appropriating ten-elevenths as its share. Regulation XIX. of 1793 showed that by the ancient law of the country the ruling power has always been entitled to a share in the produce of the soil. The payment of this land revenue or tax is a recognition of permanent rights over land, and it is to-day no uncommon experience for men, widows, and even minors to ask to be allowed to pay the demand since this is regarded as an outward sign of title to the land. The payment of land revenue, in short, is in the eyes of the cultivator a cardinal factor in village polity.

are entitled to treat it to some extent as they would other forms of rent ; that is to say, if the cash value of the concession increases, Government are entitled to take a higher cash payment for it. There is a large amount of alienated land in this Presidency and also a large amount of khalsa land, which is rented to tenants. It has been already stated before that the rent charged by the holders of these lands to their tenants far exceeds the assessment that Government get from khalsa land. When the time comes to revise a settlement, Government are fully entitled to consider what the cash value of their concession is." Vide *Bombay Legislative Council Debates*, vol. xi. part xxiii. p. 1303.

¹ Cf. Moelland, *Akbar to Aurangzeb*, p. 323 (London, Macmillan, 1923).

During the last sixty to eighty years the system has been elaborated with care, and the cultivator has been viewed with great sympathy by Government. A detailed code, for example, regulating the remission or suspension of revenue on the failure of the crops obtains in all provinces. The assessment, too, tends to leniency. "Those who are familiar with the realities of assessment know well that among Settlement Officers there is a growing inclination towards leniency of assessment. . . . The more the officers of Government know of the people, and the more intimate their mutual relations become, the less likelihood is there of severity in the enforcement of public dues. In no official relation does a member of the Public Service come into such close contact with the people as in settlement work, and it cannot be his desire to aggrieve those among whom he is spending some of the most laborious years of his life, or to initiate a settlement which, after a short interval, will break down. Every natural instinct and every recent injunction of the Supreme Government urge him to reasonableness and moderation."¹ This is no paper injunction, and steps are actually taken to ensure leniency, reasonableness, and moderation by Settlement Officers. The Mohammedan rulers carried on the system of their Hindu predecessors. This was developed, especially in the time of Akbar by his famous Hindu finance minister, Raja Todar Mal. An interesting account of this is given in the *Ain-i-Akbari*, written by Akbar's minister, Abul Fazl. When in 1765 the British assumed the Dewani of Bengal, Bihar, and Orissa, the system was given a new lease of life, but its foundations date at least from Akbar's time. Broadly speaking, there are two systems of land revenue settlement: (i.) the permanent settlement and (ii.) temporary settlements, the rates in which are revised from time to time, at present once in about thirty years.

6. The permanent settlement was initiated in 1793 by Lord Cornwallis, who was Governor-General from 1786 to 1793. This was under the orders of the British Government, and in opposition to experienced Indian officials such as Sir John Shore (afterwards Lord Teignmouth and Governor-General from 1793

¹ *Land Revenue Policy of the Indian Government*, 16th January 1902 (Calcutta, Superintendent Government Printing, 1920). It is no secret that the Resolution was written by the Governor-General himself (Lord Curzon).

to 1798) and Sir Thomas Munro. It has already been pointed out that this was effected in the same decade as witnessed the fixing for all time of the English land tax. The permanent settlement applied to the greater part of Bengal, Bihar, and Orissa, and to parts of the United Provinces, Madras, and a few other isolated tracts. At the time of the settlement the Government share of the rental was assumed to be 90 per cent, and the gross rental of the province of Bengal was Rs.4½ crores. The rental in 1899-1900 for what then was included in Bengal, Bihar, and Orissa amounted to Rs.16½ crores.¹ This came to Rs.25.35 crores in 1922-23. The increase is due partly to actual increases in rents and partly to revised methods of calculating cess. This was the rental as valued for the purpose of determining the local rates and cesses from which is mainly met the cost of district roads, primary education, and rural dispensaries.² If the existing standards in neighbouring temporarily settled tracts are applied to the area under permanent settlement in Bengal, Bihar, and Orissa, and the United Provinces (*i.e.* what in 1793 constituted Bengal), the total land revenue would be Rs.8.28 crores (£5.5 millions). In other words, the permanent settlement in these parts alone is even on present ryotwari rates a bounty of Rs.4.38 crores (£2.9 millions) to a minority of landowners as a result of the action of Lord Cornwallis. For all the permanently settled tracts in India the annual loss is in the neighbourhood of Rs.6.04 crores (£4.3 millions).³ This

¹ *Land Revenue Policy of Indian Government*, p. 56.

² Local rates are also in force elsewhere. "In the ryotwari provinces of Bombay and Madras and in Coorg the incidence of the Local Rates (for roads and schools) is precisely that in force in Bengal. This comparison involves the assumption that ryotwari revenue is the equivalent of rent; but, as a matter of fact, the extent to which sub-letting prevails in ryotwari provinces indicates that the revenue is substantially below the rental value, and the Local Rates are consequently below the Bengal level. In Lower Burma the Local Rates amount to 10 per cent and in Assam to 8.3 per cent on the ryotwari revenue. In the Punjab they are equivalent to 5.2 per cent on the rental value. In no other provinces do they exceed 4 per cent. On the North-West (*i.e.* the United Provinces) they are charged at 6 per cent, but two-fifths of the proceeds are devoted to the maintenance of the village watch, which in Bengal and other parts is a charge upon special contributions assessed and collected apart from Local Rates" (*Land Revenue Policy of Indian Government*, p. 25, para. 24).

³ This total is made up as follows: Bengal, Rs.2.12 crores; Bihar and Orissa, Rs.2.12 crores; Madras, Rs.1.18 crores; Assam, Rs.0.47 crores; United Provinces, Rs.0.14 crores, and Ajmere-Merwara, Rs.0.01 crore (*Statistical Abstract*, 1920-1921).

huge concession means that much money, so necessary for removing the blight of illiteracy and for increasing the production of wealth, slips year by year through the hands of the State.

7. Next with regard to the temporary settled tracts. The two subdivisions are (a) the "zemindari", "malguzari", or "talukdari", and (b) the "ryotwari", ryot being an Arabic word for a subject and used in India for a cultivator. Under the former system the landlord pays the land revenue to the State whether he cultivates the land himself or by means of rent-paying tenants; in the latter the cultivator pays directly to the State. The assessments are ordinarily readjusted once in the lifetime of each generation, *i.e.* once in about thirty years. In Bombay the thirty years' period was introduced by the East India Company so far back as 1837. In 1895 the Secretary of State decided after exhaustive examination that "30 years should continue to be the ordinary term of settlement in Madras, Bombay, and the North-West (now the United) Provinces, that in the Punjab 20 years should be the general rule (30 years being admitted in some cases), and in the Central Provinces 20 years also. A 30 years' term has been adopted for the recent resettlement in Orissa. In backward tracts, such as Burma and Assam, and in exceptional circumstances such as exist in Sind, shorter terms are permitted. The reasons for this differentiation are familiar and obvious. Where the land is fully cultivated, rents fair, and agricultural production not liable to violent oscillations, it is sufficient if the demands of Government are readjusted once in 30 years, *i.e.* once in the lifetime of each generation. Where the opposite conditions prevail, where there are much waste land, low rents, and a fluctuating cultivation, or again, where there is a rapid development of resources owing to the construction of roads, railways, or canals, or to an increase of population, or to a rise in prices, the postponement of resettlement for so long a period is both injurious to the people, who are unequal to the strain of a sharp enhancement, and unjust to the general taxpayer, who is temporarily deprived of the additional revenue to which he has a legitimate claim."¹ The assessments are so framed that they leave to the proprietor or to the cultivator that margin of profit which should enable him to

¹ *Land Revenue Policy of Indian Government*, p. 19 (Government Printing, Calcutta).

save in ordinary years and to meet the strain of bad years. The landlord's enhancement of the tenant's rent has been limited under the zemindari settlements for the protection of the ryot.¹ Government have also limited their own share. We have already referred to the demand at the end of the eighteenth century being the equivalent of 90 per cent of the net rental. As much as 75 per cent and over was inherited from Mahratta rule.² In the United Provinces between 1820 and 1840 the standard was five-sixths. This was lowered to two-thirds in the latter year and one-half in 1855. The Saharanpur Rules of 1855 prescribed that "the Collector will bear in mind that about one-half, and not two-thirds as heretofore, of the well-ascertained net assets should be the Government demand". This has been in practice the maximum limit. The standard rate of assessment is not to exceed half the net assets, that is, the rent when the land is let on payment of a cash rent. When the land is cultivated by the owner the net profits can be measured by the rent paid for other lands. These net profits must be as large or larger than the normal cash rent. If it is not the owner will not cultivate it. He will cultivate for wages probably some one else's land. The cash rent, of course, depends on other factors than the gross quantity of the produce; it depends on the money value of the produce after allowing for costs of production. It has also been suggested that there should be a minimum limit on the net rental.³ Since 1855 the standards have been further reduced. In the Punjab, for example, with the great increase in agricultural assets the proportion has been about one-fourth in place of one-half. There

¹ The Bengal cultivator was rackrented and oppressed under the permanent settlement, and legislative measures such as the Bengal Tenancy Act of 1859, the Act of 1885, and similar measures of more recent date had to be passed to place him in a position of greater security and to prevent the abuses of the permanently settled system.

² *Land Revenue Policy of Indian Government*, p. 12.

³ Thus a writer on land revenue in the *Times of India*, 23rd May 1924, in making a proposal that a uniform and, as far as possible, a precise method of fixing the pitch of the land assessment should be prescribed by law, wrote: "No assessment should exceed half the rent of the unimproved land (without concession to isolated instances of neglect and misuse). It might also, if the true theory of land revenue is ever accepted by a majority of the legislators, be enacted that the levy shall never be less than 40 per cent of the rental. Whenever an inadequate land revenue is levied, either the public needs are starved or an equal amount of revenue is levied from other classes of taxpayers who ought not to be called upon to contribute so long as the unearned profits of landlords have not contributed adequately."

is nothing *in law* to prevent Government from taking at the next settlement of land revenue 75 per cent or more of the economic rent. The whole system of assessment and rates of claim are based on executive order, and the jurisdiction of the ordinary courts is barred. The margin of profits to the landlord and the ratio of the produce left to the cultivator have increased, because Indian agriculturists in the view of Government will increase in efficiency the more capital returns to the land and the higher their standard of living is. Care must be taken not to confuse rent with revenue. A proportion of rent or of produce which would leave a wide margin of profit in one part of India may be vexatious elsewhere. It is not possible to reduce revenue to an exact mathematical proportion either of gross or of net produce. This, if put in force, would place burdens on people who under a less rigid system, sympathetically administered, are free from such difficulties. Permanent agricultural improvements, it should be remembered, are expressly exempt from any enhanced assessment in Bombay and Madras for ever, and in other parts of India for a period, irrespective of the term of settlement and sufficient for the capital sunk to be fully recouped from the additional assets created. If this were not done and if the cost of improvements were swept off at revision, the temporary or zemindari system would be as blundersome as the permanent revenue settlement.

India is to-day perhaps unique in the up-to-dateness of its cadastre or survey. Each field is measured up and the local official keeps the details of the crops sown. The various entries prescribed in the land revenue codes are checked by inspecting officials. This applies to all tracts which have not been permanently settled. The actual details of settlement vary from province to province, although there is a family likeness common to all. In Bombay, for example, the basis of settlement is the survey number, which is a piece of land suitable for cultivation by a cultivator with a pair of bullocks. Arable land is divided into these survey numbers and the area is carefully surveyed. The soil of each survey number is classified according to the depth and texture of the soil. This is the chief factor which determines the assessment of each field. Sixteen annas (the number of annas in a rupee) represents the best soil, and the soils below this in quality are fixed at so many annas. The measuring and classifica-

tion or soil valuation have, of course, nothing to do with the assessment, but are only the means of distributing the assessment over the holdings in the ryotwari system. This operation of valuing relatively the soils is now complete, and however much in future the total amount of the assessments are changed, this classification remains unalterable, *i.e.* the distribution between field and field will be the same as at present. The rates of assessment are worked out for groups into which the taluka or subdivision of the district is divided according to economic circles. Physical homogeneity, and climate, rainfall, general fertility, communications, are considered in this grouping. For each of these groups maximum rates are fixed. These maximum rates are leviable upon fields the soil valuation of which is sixteen annas.

Thus, if the maximum rate be Rs.3 per acre of a sixteen-anna field, the assessment per acre on a field valued at eight annas would be Rs.1.8.0. Before fixing the maximum assessment rates the Settlement Officer reviews prices, wages, rents, rainfall, the selling, letting, and mortgage value of the land, and similar factors. The cash rents paid and the selling value of the land are of supreme importance as a guide, although sometimes neglected. Upon an examination of the factors he bases his proposals for enhancement or reduction of assessment. If he finds that the condition of the countryside has not been improving and prices have been stationary, he will not propose any enhancement. If he thinks that cultivation has been contracted and the land revenue difficult to collect, he will suggest a reduction in that area. If, on the contrary, there has been a large increase in cultivation, if the letting and mortgage values of the land have increased, if the assessment is paid with ease, he will propose an increase of assessment. When once a settlement has been done—Bombay owes much to Pringle and a large and honoured band of Settlement Officers—a revision is not a difficult matter. The method of revising the maximum rates applicable to each field, according to the classification of the soil, brings about a result the effects of which are equitable through each group, village, and field. In Madras and other provinces there are differences in detail, but it is fairly clear that not even in the Roman Empire or in the Domesday Book was there so detailed a cadastre as in India to-day.

The incidence per acre ¹ fully assessed varies, often considerably, from province to province. The following is the incidence per acre in the permanently settled tracts, together with the temporarily settled tracts.

RATES PER ACRE (fully assessed)

	Permanent Settlement.	Temporary Settlement.		
		Zemindari.	Ryotwari.	
	Rs. A. P.	Rs. A. P.	Rs. A. P.	
Bengal	0 9 0	1 2 9	..	
Manipur . . . . .	..	..	1 8 10	
Bihar and Orissa	0 4 4	0 13 0	..	
Assam	0 1 6	1 4 8	2 0 8	
United Provinces :				
Agra	0 15 0	1 3 0	..	
Oudh	0 14 1	1 4 2	..	
Madras	0 10 3	..	1 14 5	
Coorg . . . . .	..	..	2 5 8	
Bombay . . . . .	..	0 8 0	1 3 8	
Sind . . . . .	..	..	2 1 9	
Ajmere Merwara	0 2 2	0 4 7	..	
Punjab . . . . .	..	0 15 0	..	
Delhi . . . . .	..	1 0 10	..	
Burma (Upper) . . . . .	..	..	0 8 11	
Burma (Lower) . . . . .	..	..	2 12 1	
Central Provinces . . . . .	..	0 6 6	0 3 10	
Berar . . . . .	..	..	1 1 9	
North-West Frontier Province . . . . .	..	0 4 10	..	

¹ The incidence of land revenue per head of the population in recent years is shown below together with the *per capita* incidence of taxation including and excluding land revenue :

Years.	Taxation excluding Land Revenue <i>per capita</i> .	Taxation including Land Revenue <i>per capita</i> .	Land Revenue <i>per capita</i> .
	£ s. d.	£ s. d.	£ s. d.
1911-12	1 7 11	2 11 8	1 3 9
1912-13	1 9 8	2 13 10	1 4 2
1913-14	1 10 9	2 15 0	1 5 3
1914-15	1 9 7	2 13 7	1 4 0
1915-16	1 9 1	2 13 10	1 4 9
1916-17	1 15 4	3 4 2	1 4 10
1917-18	2 5 6	3 9 10	1 4 4
1918-19	2 7 10	3 11 8	1 3 10
1919-20	3 4 0	4 9 3	1 5 3
1920-21	3 10 3	4 14 2	1 3 11

(Statistical Abstract, 1920-1921.)

To any one who knows the capital value of the land these figures are low, especially since the beginning of the present century, when India became closely knitted up in her economic solidarity to the outside world. In 1832 the selling value of inherited (*miras*) land in the Deccan was no more than two or three years' purchase. Land yielding Rs.200 gross produce could seldom be mortgaged for more than Rs.100. The selling value of land in the talukas of the Bombay Presidency that were settled in the quinquennium ended 1901 was 24·8 times the assessment. The mortgaging value of the land was about 19 times the assessment. The letting value, *i.e.* the average rate of rent, was 3·2 times the land revenue. An examination of recent settlement reports¹ shows that land in the Bombay Presidency has been selling for about 80 times, and has been mortgaged for about 40 to 50 times, the assessment. The letting value was about 6 times the land revenue. Thus the settlement reports of Sholapur (Malsiras), East Khandesh (Jamner, Bhusawal, Erandol, and Parola), and the Upper Sind Frontier (Shahdadt), show that the selling value was 93·23 times the assessment in Erandol, 86 times in Bhusawal, 81 times in Malsiras, 78 times in Jamner, 61·56 times in Parola, and 19·3 times in Upper Sind. These values of land subject to full Government assessment, especially in view of the high rates of interest, are very illuminating.

To-day, land revenue is only 17 per cent of the total revenue

LAND REVENUE

		Crores of Rupces.	Percentage to Total Gross Revenue.	Percentage of Total Direct Taxation to Gross Revenue.
1861-62.	Sixty years ago .	20	45	52
1871-72.	Fifty years ago .	21	41	44
1881-82.	Forty years ago .	22	29	35
1891-92.	Thirty years ago .	24	27	34
1901-02.	Twenty years ago .	27	28	33
1911-12.	Ten years ago .	31	25	29
1921-22.	To-day . .	35	17	30

¹ 1911-1920.

of the Central and Provincial Governments. It is interesting to examine the relatively large importance which land revenue had in Indian finance half a century ago. The relative insignificance of land revenue in subsequent years is due to the fact that other sources of revenue have increased. The percentage of land revenue to total gross revenue has, therefore, declined.

As one glances down the foregoing table the figures strike one in the eye. The statistics will be found in greater detail in Table XV., App. The burden of land revenue cannot be estimated merely from the amount of revenue collected, as prices fluctuate, or, in other words, the purchasing power of money does not remain stationary at different periods. During the last twenty years land revenue, when it was not permanently fixed under the Permanent Settlement, increased only at an average rate of 1 per cent per annum. Until the Reforms no real attempt was made to look for new sources of public income. In some provinces, notably, for example, Bihar and Orissa and Bengal, the land tax is totally insufficient for provincial needs, which must continue to expand. While the land revenue is no longer one of the chief sources of central finance, it is still so of provincial finance. In Bombay, for example, the administration has to be paid for mainly from two main heads of revenue—land revenue and excise—both of which are liable to vary greatly owing to a failure of the rains or other calamity. This is a serious matter when large recurring expenditure on education and other social services has to be met. The question, therefore, of the best method of taxing land is a pressing one in this country. There is as yet no income tax on income from land and agricultural profits as in Schedules A and B of the British Income Tax. Moreover, income tax is a central, not a provincial, head of revenue, and when a general inquiry into taxation is undertaken by the Government, as it must do in the very near future, the system of land taxation now in force must needs come under scrutiny. Before 1917, when income tax was systematised as well as overhauled, direct taxation meant little else than land revenue, and finance was in fact simply the most cheese-paring and rigid economy which was intended to keep the cost of government within an inexpansive system of taxation. An over-cautious Government, unwilling to look for new sources

of income, was like the worker in a Bombay mill, ignorant of a banking account and of finance except as expressed in terms of an inadequate income against a low expenditure or standard of living. With the Constitution of 1919 all is changed, and in the near future the weakest part of the Reforms, the field of public finance, will require scrutiny. Indeed, federal and provincial finance are delicate pieces of furniture, the cobwebs of which cannot be removed by a Turk's head mop.

8. What then, it may be asked, is to be the future of land revenue in India—that ancient seigniorial claim of the State universally recognised as a liability and as an obligation attaching to rights in land throughout the country? The Joint Committee of Parliament in their Report on the Government of India Bill recommended that the principles governing this source of revenue should be reduced to statutory form so far as this has not been done.¹ In other words, the Committee suggest that land revenue should no longer depend with its honeycomb of codes and rules on executive fiat but on legislative authority. If this were effected, the rate of tax and the period of its revision would be a legal process.

In the permanently settled tracts the solution will be an income tax on landlords enjoying the present bounty of nearly Rs.6·04 crores or £4·3 millions per annum—an income tax similar to Schedules A and B of the British Income Tax, by means of which the difficulties of the English permanent settlement of 1798 fixing the land tax for all time have been on the whole successfully solved. The possibility of buying out the landlords created by the permanent settlement of 1798 is altogether outside practical finance. In regard to the temporarily settled tracts one or two points stand out as clear as the noonday. The revision of the present system modified to suit changed conditions, and the extension of the income tax to agricultural

¹ "The Committee are of opinion that the time has come to embody in the law the main principles by which the land revenue is determined, the methods of valuation, the pitch of assessment, the periods of revision, the graduation of enhancements, and the other chief processes which touch the well-being of the revenue payers" (paragraph 11 of the Report). In accordance with the above recommendation a resolution was moved in the Budget session of the Bombay Legislative Council in 1924 for appointing a Committee "to consider the question of bringing the process of revising the land revenue assessment under closer regulation by statute". A similar step has been taken in the Madras Presidency.

incomes, appear to be the best course of action. If the present scheme, a very old one, is retained, (1) an increase in the pitch of assessment on land (land revenue, the main head of provincial revenues) will be required to enable provinces to proceed with compulsory and universal primary education and other social services ; (2) a shortening of the period of temporary settlements may be deemed necessary from the financial point of view to meet the cost of those charges. There may be opposition to the shortening of the period, and some writers, like Lord Meston, believe that there will be "the almost certain abolition of periodical revisions of the land revenue, at least in the provinces where there are landlords intermediary between the cultivator and the State".¹ There are others who are of opinion that the period of temporary settlements may be extended ; (3) the extent of the enhancement imposable at each successive settlement may have to be reviewed and probably, on the whole, increased. In some areas, of course, where considerable changes take place economically, a reduction may be even necessary. The enhancement should depend not on any arbitrary percentage limit but on local circumstances, including prices, rental, and sale statistics. Too great care cannot be taken in order to discover the rental of the landlord and the share that may be rightly claimed by the State. If these measures are not possible of adoption, it will be necessary to impose a tax on the income of landlords from agriculture, as in Schedules A and B of the British Income Tax. This would be lower than that in permanently settled areas, since the permanently settled areas would have to bear for provincial revenues an additional tax to bring up the rate paid by landlords to that corresponding in ryotwari tracts. The alternative scheme of abolishing land revenue and of having in its stead a detailed system of income tax on agricultural incomes and profits loses, it is argued, the claim of the State, which is not a demand in virtue of its taxing power but a claim attaching to rights in land from ancient times. The redemption of the annual land revenue by the payment of the capitalised amount and the extension of the system of permanent settlement are Utopian. Land revenue at the moment is not an elastic source of revenue. The Japanese

¹ *The New Constitution of India*, p. 171. Ilbert and Meston. (London University Press, 1923.)

system of fixing annually a percentage on the capitalised value of the land is very attractive, as it makes for elasticity. In the Russo-Japanese War we have seen Japan was able to increase the percentage without difficulty. These problems require the best brains of the country. The placid contentment with the present system is, in some quarters, regarded as no reason for delay in an examination of the land revenue system and of the basis of local rates or cesses. In the memorable words uttered in the House of Commons on that August afternoon of 1917, our goal is "the gradual development of self-governing institutions with a view to the progressive realisation of responsible government in India as an integral part of the Empire". This means much provincial expenditure on, for example, more and better education, and that in turn demands an examination of our system of land taxation, a system which is a matter of the most intimate concern of Government, since on it the prosperity of the masses to a large degree depends.

UNITED STATES

9. Land taxation in most of the 48 states of the Union is the main source of provincial or State revenue.¹ It is not usually a progressive tax, as in the Swiss cantons, but a tax of $1\frac{1}{2}$ to 2 per cent on land and also on buildings. A feature of the American tax is the system of apportionment by which a given sum is raised among the counties in proportion to their assessment and the valuation of property. It is unnecessary here to trace the division of the states into counties, townships, and their subdivisions, or the homestead system of granting lands to actual settlers at a cost of about \$26 per acre for 160 acres or a "quarter section". The interest on this at 6 per cent represents an annual rent of 1 per cent per acre, which is, as F. A. Walker points out, as nearly as possible the "no-rent land" of the

¹ About 55 or 60 per cent of the net revenue receipts of states or provincial governments are from property taxes; 20 per cent from business and non-business licence taxes; 11 per cent from earnings of general departments; and 6 per cent from highway privileges, rents, interest, and earnings of public service enterprise: the remainder is from special taxes and fines, etc. In 146 cities the general property tax is 66 per cent of the net revenue receipts, the next most important source being earnings of public service enterprises (10 per cent), and the remainder other taxes, subventions, and special assessments.

economists. Criticisms of the property tax are thick as the leaves of Vallombrosa. It is said that the valuation of property is on account of the system of apportionment put at the lowest figure by the officials in each county. In this as in all other tax matters efficient officials, incapable of being ejected at the time of each new election and other political vicissitudes, are fundamentally necessary. In Ohio real property is valued once in ten years by assessors appointed who are to estimate each plot "at its true value in money". This valuation in many states is unsatisfactory. The property tax, while applicable to all property, is in fact applied only to real estate and to those forms of personal property which are easy to see, such as plant, machinery, animals, and buildings. Evasion is the rule and not the exception, probably because of the breakdown in applying it to the ownership of property in corporate form. It acts as an incentive to dishonesty, since people can evade the tax by converting their property into personalty, which more often than not escapes assessment. In addition to want of uniformity in assessment consequent on the valuation work being entrusted to local authorities and to evasion, the American property tax has the fault of being regressive, and it leads to double taxation. It is regressive because it presses hard on farmers whose realty and personalty are easily assessed, while those often with huge incomes who derive their income from industrial and commercial concerns escape scot free. It leads to double taxation because in some cases both the debtor and the creditor are charged for the same sum. "In New York", says one writer,¹ "any one who is dissatisfied with the tax collector's demands on him not only declares his real debts but cooks up a debt if necessary; perhaps swears to one that does not exist or salves his conscience (men do such things) by getting a friend to become *pro forma* a creditor. The process of swearing off the assessments of personal property is carried so far in New York as to make this part of the tax system a farce". These criticisms do not all apply to the Swiss property tax. They show, however, some of the dangers to be met with in the taxation of property.²

¹ Taussig, *Principles of Economics*, vol. ii. p. 531 (Macmillan).

² Cf. Seligman's *Essays in Taxation* (1921), p. 19 (Macmillan).

CHINA

10. In China land taxes are, with the salt duty and customs, the mainstay of Chinese revenue. In recent years the salt gabelle has become more important than the land tax. In 1712 the poll tax on adult males was combined with the land tax, and at the same time it was decreed that the amount of the land tax should be permanent for all time. The Central Government of China has, it appears, kept this promise because in spite of the struggle of the Government to make both ends meet the land tax has not been increased. The amount of tax due on each plot of land is entered on the title-deed, and once entered cannot be changed. As in India, temporary remissions of revenue are granted on account of famine or floods, and in China rebellions have also been the cause of temporary remissions. With the exception of the two provinces Kiang-su and Cheh-Kiang, which pay their taxes in grain, all pay in silver. The value of the grain forwarded, usually called tribute rice, is about taels 6,500,000. The payments in silver amount to taels 25,000,000. Thus the total yield of the tax to the Central Government is taels 31,500,000, or nearly £5,000,000 or Rs.750 lakhs. For a country one-third larger than India, with a population in the neighbourhood of 400 millions,¹ and with a more fertile soil, this is at first sight small. This, however, is only a fraction of the amount actually paid by the cultivators. It represents, in short, only the amount for which the various magistrates have to account. Nothing is allowed for the cost of collection, which has to be added. "This", writes a distinguished public servant of long experience in China, "they usually do by declaring the taxes leviable not in silver, but in copper 'cash', which indeed is the only currency that circulates in country places, and by fixing the rate of exchange to suit themselves. Thus while the market rate is, say, 1500 cash to the tael, they declare by general proclamation that for tax-paying purposes cash will be received at the rate of 3500 or 4000 to the tael. Thus while the nominal land tax in silver remains the same it is in effect doubled or trebled, and, what is

¹ Various estimates have been made. One for 1921 put the population, excluding Manchuria, as high as 443,000,000. A former American Minister at Peking, writing in 1912, says it "is much smaller than we have been led to believe, and in the last century it has been increasing very slowly, if at all".

worse, no return is made or account required of the extra sums thus levied. Each magistrate or collector is in effect a farmer. The sum standing opposite the name of his district is the sum which he is bound to return under penalty of dismissal, but all sums which he can scrape together over and above are the perquisites of office less his necessary expenses. Custom, no doubt, sets bounds to his rapacity. If he went too far he would provoke a riot; but one may safely say there never is any reduction, what change can be effected being in the upward direction. According to the best information obtainable, a moderate estimate of the sums actually paid by the cultivators would give two shillings per acre. This on an estimate of the area under cultivation should give for the eighteen provinces £19,000,000¹ as being actually levied, or more than four times what is returned".²

JAPAN

11. The taxation of land in Japan is in marked contrast to that which obtains in China. It is based on the assessed value of land, which is arrived at by capitalising the annual rental of the land whether for residential or cultivation purposes. The State imposes a land tax of 2·5 per cent on residential land, 4·5 per cent on rice and other cultivated land,³ and 5·5 per cent on land other than residential and cultivated land. In Hokkaido, however, the rate for cultivated land is 3·2 per cent, and for other land, except dwelling land, 4 per cent. Prefectures, cities, towns, and villages are permitted as public bodies to levy an additional tax (*fukazei*) on the land tax for purposes of revenue. The rate of this additional tax is by no means uniform but varies according to local financial conditions. In the event of the tax exceeding a certain limit, the sanction of the Central Government has to be obtained. A Water Utilisation Association

¹ Or Ra.2850 lakhs.

² Mr. G. Jamieson, C.M.G., M.A., formerly Consul-General at Shanghai, and Consul and Judge of the Supreme Court, Shanghai. (Cf. *Encyclopædia Britannica*, 11th edition, vol. vi. p. 186; chapter xxv., "Finance", in the *China Year-Book*, 1923 (Tientsin Press, Tientsin).)

³ Land is, in addition, subject to income tax. In the case of rice fields or dry farms the average surplus of receipts over necessary disbursements during the last three years is liable to income tax. In the case of lands left uncultivated the income is assumed to be the same as that for adjoining farms of similar grade (see Chapter XXI.).

(which must be a juridical person) carries out irrigation or drainage works, and may charge its expenses against the land benefited. This is not included in the additional tax (*fukazei*) above.

At the time of the abolition of feudalism in 1871 the land tax constituted nine-tenths of the feudal revenues, and it was necessary to replace the various rates by a uniform system. For this a reassessment was imperative, and it could not be delayed. It was roughly made in the space of two years, and was improved on in the following years. It was completed in 1881. This survey was extremely liberal to the agriculturist, whose land is assessed at certainly not more than one-half of the market value. By the change the agriculturist acquired the fee simple of his land on payment of the annual land tax to the Government. By 1923 the capital value of land has increased very greatly, as compared with rates fixed some forty-five years ago, and the assessed values therefore differ widely from the capital values. Nevertheless, these have been for the present retained, except for residential land. The capital value of cultivated land for assessment purposes was arrived at by capitalising the net earnings or the rental value. The net earnings were calculated by deducting from the produce the cost of seed and manure, rates, and taxes. The amended official value of residential land is taken as ten times the annual rental. The real (or as it is sometimes called, the "legal") value of the land is, when required, obtained by comparing the land with other land the value of which has been established.

The value of wet land per acre in the last quinquennium was approximately yen 143 (Rs.215), and of dry land, yen 37 (Rs.56). The average land tax would thus work out to yen 6.4 or Rs.9.11-0 for wet land, and yen 1.7 or Rs.2-8-0 for dry land, or an average of something like Rs.6 per acre. The corresponding rates in India were: for wet and dry together, Rs.2-14-0 in Lower Burma, Rs.2-9-0 in Madras, Rs.1-6-0 in Bombay, Rs.1-5-0 in Berar, and 10 annas in the Central Provinces. In Sind, where nine-tenths of the land tax is for irrigation, the rate was Rs.3-1-0. The superiority of the Japanese land tax over that of India lies in its elasticity. Thus in an emergency (as in the Russo-Japanese War) the tax could be raised without difficulty by increasing the percentage payable on the assessed value of the land. .

CONCLUSION

12. In paragraph 1 above we have discussed the general features of land taxation, and in subsequent paragraphs have referred to some of the systems in force in regard to land taxation. In all modern countries the taxation of land is an important part of a diversified tax system, for the simple reason that land cannot be removed, and the owners of the land have to submit to the taxation which is imposed on them. In the United States taxes on land are usually assessed on the value. Thus in the United States there is frequently a tax on real property of, say, \$1.50 per \$100 of the selling value, or $1\frac{1}{2}$ per cent on the owner's capital. In Great Britain the tax is, say, 5s. in the £ rental value on the occupier, *i.e.* 25 per cent of the rental. There is also a system of taxing profits. In the former system land is forced into use much more quickly than in Great Britain, where land comes more slowly into the market. In America, for example, the owner, being taxed on the capital value of the land, is forced in his own interests to make the rental of the land the same as the potential economic rent. The community, too, obtains through taxation a large share of the unearned increment. In most countries the taxation of land, as of buildings, is regarded as a suitable source of revenue for local taxation.

CHAPTER XXI

THE TAXATION OF INCOME (HISTORY)

1. THE spur of taxation has nowhere been more clearly seen in the twentieth century than in the system of taxation known as the income tax. The income tax is a corpus or code of taxation rather than a single tax, and every well-balanced financial system nowadays derives a large part of its receipts from direct taxation, mainly income tax.¹ If this were not so, the burden of taxation would be unfairly distributed. Since the War income tax has become a great engine of revenue, especially for the balancing of budgets. The increases during the difficult times of the last few years have almost been phenomenal. In Great Britain the percentage of revenue from income tax to total tax revenue has increased from 29 per cent in the pre-War year to 47 per cent in 1921-22; in India ² from 4 per cent to 19 per cent in the same period; and in the United States from 11 per cent of the Federal revenue in 1915-16 to 85 per cent. In Japan the pre-War percentage was 10, and it is now 36.³ Only in the rarest of instances has the income tax borne a less proportion of total tax revenue than in the pre-War period.

There are other reasons why the income tax has been given a deservedly high place in the treatment of the science of Public Finance. It has become universal in all the chief industrial countries. In the United States, for example, as we have already seen, the foundation of the Federal income tax was laid in February 1913, when the Sixteenth Amendment was ratified. In Great Britain a Departmental Committee, and subsequently a

¹ For the proportion of direct and indirect taxes in certain countries see Table XXIV., App.

² Central revenue only.

³ See Table XXIV., App.

Joint Select Committee of the House of Lords and the House of Commons, surveyed the whole field of income tax, and as a result 13 Acts and parts of 39 other Acts were repealed by a Consolidating Act, the Income Tax Act of 1918 (8 & 9 Geo. V. c. 40). This Act was passed on 8th August 1918 and came into effect from 6th April 1919. The Report of the Royal Commission¹ is undoubtedly the *locus classicus* on the subject of taxation of income. The terms of reference were "to inquire into the income tax (including super tax) of the United Kingdom in all its aspects, including the scope, rates, and incidence of the tax; allowances and reliefs; administration, assessment, appeal, and collection and prevention of evasion; and to report what alterations of law and practice are necessary or desirable and what effect they would have on rates of taxes, if it were necessary to maintain the total yield". The object of the Commission was limited to this: to improve the equitableness of the tax without, in any way, making it less effective. The evidence and appendices to the Report on the history of the income tax system in its various aspects, especially in regard to graduation, abatements, and differentiation, taxation at source and evasion prepared by the Board of Inland Revenue, as well as the statistics in the reports, are a mine of information applicable in a large degree to all countries where an income tax obtains. In India the system of taxation of incomes has hitherto been undeveloped, but with the passing of the Indian Income Tax Act (No. XI. of 1922) and the formation of a Board of Central Revenue, the income tax has been given a greater importance than in any period of its history from the date when it was first introduced in 1860. In Japan the income tax introduced in 1887 and modified in 1899 was completely revised in 1920. We have seen elsewhere how in France a general income tax was put upon the Statute Book just before the outbreak of War, how the old direct taxes on real estate were converted into taxes on income from real estate, and how the income tax from industrial, commercial, and agricultural produce, as well as salaries, etc., took the place of the old taxes on doors and windows, trades and professions.²

¹ Cmd. 615. The Report and Minutes of Evidence are published in 9 volumes. The numbers of the minutes of evidence are as follows: 288, 1 (1919), 1st instalment; 288, 2 (1919), 2nd instalment; 288, 3 (1919), 3rd instalment; 288, 4 (1919), 4th instalment; 288, 5 (1919), 5th instalment; 288, 6 (1920), 6th instalment; 288, 7 (1920), 7th instalment; 288, 8 (1920), index.

² Vide § 8, Chapter XVI. p. 156.

It would be tedious to review the detailed changes made during the present century in other countries of Continental Europe. The words of Gladstone in the British House of Commons uttered over seventy years ago are truer than ever. "I for one", he said in his first Budget speech,¹ "am bold enough to hope and to expect that in reforming your own fiscal and commercial system, you have laid the foundation of similar reforms—slow, perhaps, but certain in their progress—through every country of the civilised world".

Before dealing with principles it will be convenient to examine in some detail the history of the income tax in certain countries. We have to be careful not to nibble at a subject like this, and we have to look to the general effect on the whole system, especially in times of stress and strain, when Budgets have to be balanced. The taxation of corporations may or may not be discussed under income taxation. The case for a discussion in this connection is the growing tendency in most countries to tax corporations on their income, and not on any other basis. On the other hand, corporations are taxed because of their privilege to be corporations and to do business as corporations and, in some cases, to do it in a particular way. In the eyes of the law a corporation is a person who exists although the individual shareholders may die. It has, in other words, a juristic personality. It also has the right of limited liability, a term too well understood to require explanation. Sometimes corporations are taxed on the basis of their income, sometimes on the value of their property or the volume of their business. All things considered, it is advisable to postpone a detailed consideration of a corporation tax to a subsequent chapter.²

GREAT BRITAIN

2. Ninety per cent of the British income tax is derived from the incomes of individuals; the remainder is from the income belonging to and retained by corporations (*e.g.* undistributed profits of limited liability companies) or from the income of persons resident abroad. The tax is one tax on the total income of a person imposed at a standard rate for a year of assessment, *i.e.* from the 6th April in one calendar year to the 5th April of the following year.

¹ 18th April 1853.

² *Vide* Chapter XXIV.

The tax may be traced from the scutage of the Norman kings to the "tenths" and "fifteenths", the Commonwealth "monthly assessment", the eighteenth-century land tax, the assessed taxes including the triple assessment of Pitt, the income tax of the period 1798-1816, and finally the tax as revised by Peel in 1843. It is on record that in 1193 in the time of King Richard, a charge upon every person in the kingdom in respect of rents and goods was levied for the ransom of the king. At the beginning of the 13th century there was a tax on movables to assist the king in finding funds for crusades.¹ In 1435 we find references to a graduated income tax. This was granted with the fifteenth and tenth, and all annuitants and persons deriving incomes from offices and freehold had to pay the tax. In 1450 an income tax was similarly levied on lands, tenements, rents, services, annuities, offices, fees, profits, or commodities.² It is, however, wearisome and unnecessary to trace the earlier history of these taxes, until we come to Pitt's assessed taxes, *i.e.* taxes on houses, carriages, servants, saddle carriage and race horses, and armorial bearings, which depended on the amount of income of the assessee, provided the income was £60 or upwards. This was repealed in 1799. This gave way to a system of income tax which imposed a duty of 10 per cent on all incomes from whatever source derived, incomes under £60 a year being exempt, and reduced rates being charged on incomes between £60 and £200. This latter tax was a shade over £6 millions for the first year as compared with under £2 millions produced by the earlier tax. On the Peace of Amiens this income tax was repealed, only to be renewed in the following year when war broke out in 1803. When the tax was thus reimposed the previous general return of income was done away with, and particular returns in five schedules A, B, C, D, and E were introduced for particular sources of income.³ A rate of 5 per cent was imposed on all incomes of £150 a year and over, with graduation on incomes between £60 and £150. This income tax of 5 per cent was collected at its source, and yielded nearly as much as the previous tax of 10 per cent collected direct from each taxpayer. The tax was continued from year to year with variations in the rate until the close of the war in 1816, when it

¹ Dowell's *History of Taxation and Taxes in England*, vol. i. p. 68 (Longmans & Co.).

² Dowell, vol. i. p. 127.

³ 43 Geo. III. c. 122.

was repealed. Sir Robert Peel revived it in 1842, to enable him to introduce his fiscal reforms.

Changes in regard to income tax took place in the last decade of the nineteenth century and the first two decades of the twentieth century, the most important of them being found in the Finance Acts of 1894, 1897, 1898, 1907, 1909-1910, and 1914. The Finance Act of 1894 fixed the total limit of exemption at £150, and the Finance Act of 1907 distinguished between "earned" and "unearned" income, granting relief to earned income as compared with unearned or invested income by 3d. in the £ where the income from all sources did not exceed £2000. The Act of 1898 revised the scale of abatements up to £700. The Act of 1909 introduced principles of graduation and differentiation on the lines recommended by the Select Committee in 1906.¹ This Select Committee concluded that (1) graduation of the income tax by an extension of the existing system of abatements was practicable; (2) graduation by a super tax was also practicable; (3) collection at the source should be continued, and the principle of direct personal assessment of the whole of each person's income was not expedient; (4) differentiation between earned and unearned incomes was practicable, especially if it be limited to earned incomes not exceeding a certain sum a year, earned income being charged at a lower rate of tax; and (5) a compulsory personal declaration by each individual of the total net income on which the tax was payable was necessary, and would do much to prevent evasion. In 1909, therefore, the rate upon earned incomes of persons whose total income did not exceed £2000 was left unchanged, but the rate on all investment or unearned incomes, and on the earned portion of incomes over £2000 from all sources was raised to 14d. A super tax of 6d. in the £ was levied on all incomes exceeding £5000 a year, the super tax being paid only upon the amount by which the incomes exceeded £3000 a year and not on the whole amount. A special abatement of £10 for every child under the age of sixteen was allowed upon all incomes under £500 a year. No abatements or exemptions were allowed to persons not resident in the United Kingdom, except in the case of Civil Servants and also persons residing abroad on account of their health. Nowadays all British subjects are entitled to those

¹ Cmd. 365 of 1906.

reliefs. Certain abatements for improvements were allowed to the owners of land or houses. In 1910, in short, the rate of tax was 14d. in the £ and the exemption limit was £160. Earned income paid at 9d. in the £ if the total income did not exceed £2000, and 12d. in the £ if the total income did not exceed £3000. The earned income over £3000 limit and all unearned income paid at 14d. in the £. Graduation was effected partly by a series of abatements and partly by the super tax. Abatements were £160 for individuals whose incomes did not exceed £400; £150 for individuals whose incomes did not exceed £500; £120 for individuals whose incomes did not exceed £600, and £70 for incomes not exceeding £700. The super tax was charged on incomes exceeding £5000 at 6d. in the £ on every £ by which the income exceeded £3000. In 1910, it will be seen, the principle of graduation was imperfectly applied. Between £701, where the abatement ceased to apply, and £5000, where the super tax began, there was no graduation at all. Until the Finance Act of 1914 increased the rate to 15d. there was practically no change. In 1914, however, the rate on earned income rose by five steps instead of three to the maximum rate. The maximum rate came into force on incomes above £2500. Unearned incomes, graduated now for the first time, rose by three steps to the maximum rate. The maximum rate was charged on incomes above £500. The super tax limit was reduced from £5000 to £3000, and was no longer charged at a flat rate of 6d., but was charged at seven rates varying from 5d. to 16d. in the £ on successive slices of income. The children allowance was increased to £20. Owing to the War the second Finance Act of 1914 increased the rate of tax from 15d. to 20d.; the first Finance Act of 1915 increased this to 2s. 6d., and the second to 3s., while in 1916 it rose to 5s., and in 1918 to 6s. in the £. Before 1914 the rate had been as low as 2d. in the years 1874–1876, and as high as 16d. in 1855–57. In 1918, the year of the Armistice, the super tax limit was reduced from £3000 to £2500, the super tax being leviable on incomes in excess of £2000, with a new scale of charges running up to 4s. 6d. in the £. Besides these changes in the rates, the exemption limit of income tax was reduced to £130, which brought within the net wage-earning classes which hitherto had been unaccustomed to the payment of any annual tax. In order to meet this class it was decided to assess

quarterly, and to collect the tax quarterly from weekly wage-earners employed by way of manual labour, and this was afterwards effected by the purchase of income tax stamps which were fixed on a card and ultimately handed to the collector of income tax. During the War special reliefs were given to those who were soldiers and sailors; a further increase in children's allowance, and the grant, for the first time, of an allowance for a wife in order that the heavy burden of taxation may be more fairly distributed in the case of married men as compared with the bachelor, came into force. Since the War the net produce of the tax and the incomes on which the taxes were received (*i.e.* after the deduction of allowances and reliefs) and the normal rates of tax are shown in the following table :

INCOME TAX (EXCLUDING SUPER TAX)

Number of Persons chargeable.			Percentage of Total Population.	Yield of the Tax.	Taxable Income.	Rate.
Thousands.				Million £.	Million £.	s. d.
1918-19	.	3547	7.7	304	1287	6 0
1919-20	.	3900	8.3	337	1416	6 0
1920-21	.	3000	6.3	353	1357	6 0
1921-22	.	2400	5.1	352	1350	6 0

SUPER TAX

Year.	Yield of Super Tax.	Total Income, <i>i.e.</i> including Income on which no Super Tax is payable.	Income chargeable.
	Million £.	Million £.	
1918-19	36	356	exceeding £2500
1919-20	42	410	" "
1920-21	56	505	exceeding £2000
1921-22	61	550	" "

In the Finance Act of 1920 effect was given to certain recommendations of the Royal Commission presided over by Lord Colwyn. The Report, it may be mentioned, was signed by all the twenty-three Commissioners, the reservations being of trifling importance. A new plan of differentiation, graduation, and allowance was adopted on the lines proposed by the Commission, and the relief proposed for double taxation within the Empire was passed into law. At the same time incomes exceeding

£2000 were liable to super tax, and the super-tax rates were increased in general conformity with the recommendations of the Royal Commission. The Finance Acts of 1921, 1922, and 1923 contained no important changes, the rate remaining at 6s. in the £ for 1921-22 and 4s. 6d. for 1922-23. The super-tax rates on successive slices of income were in 1923 as follows :

	s.	d.
In respect of the first £2000 of the income	nil.	
In respect of excess over £2000—		
For every £1 of the first £500 of the excess (to £2,500) .	1	6
„ £1 of the next £500 „ „ (to £3,000) .	2	0
„ £1 „ £1,000 „ „ (to £4,000) .	2	6
„ £1 „ £1,000 „ „ (to £5,000) .	3	0
„ £1 „ £1,000 „ „ (to £6,000) .	3	6
„ £1 „ £1,000 „ „ (to £7,000) .	4	0
„ £1 „ £1,000 „ „ (to £8,000) .	4	6
„ £1 „ £12,000 „ „ (to £20,000) .	5	0
„ £1 „ £10,000 „ „ (to £30,000) .	5	6
„ £1 of remainder of the excess (above £30,000) .	6	0

On all incomes above a hundred thousand pounds a year the effective rate of income tax, including super tax, was more than 11s. 6d. in the £ in 1921-22. This effective rate of tax is arrived at by dividing an individual's total income tax payable by his total statutory income, *i.e.* as we shall see later, his gross income, allowing for certain exemptions and reductions.

3. Before proceeding to deal with the more or less technical points connected with the recommendations of the Royal Commission it may be convenient here to refer briefly to the various schedules in force, as these are older than any other schedules in modern taxation, dating as they do from 1803.

Schedule A includes income from the ownership of lands, houses, tenements, etc. In the case of the administrative county of London, the annual value is arrived at under the Valuation (Metropolis) Act, 1869, where the valuation serves both for the purposes of income tax and the rates framed for local purposes. In the areas in Scotland where the Valuation Assessor under the Lands Valuation (Scotland) Act of 1857 is the Inspector of Taxes, the assessment and the annual value for income-tax purposes follow the valuation made under the Act. In Ireland the determination of annual value is governed, subject to certain exceptions, by poor-rate valuations. As a general rule, the annual value or rent for the purposes of Schedule A is deter-

mined periodically, and the value thus fixed is continued, subject to certain qualifications, during the intervening years. Outside the county of London, for example, the last general re-assessment was made in 1910, and the new assessment for Great Britain, excluding the county of London, and for northern Ireland, came into force for the year of assessment 1923-24. In the county of London new assessments were made in 1916 and 1921. The annual value fixed is subject to increase in the case of structural alterations to any property, and new properties are assessed at their appropriate annual values. In the county of London reductions of annual values follow reductions in the values for rates, but elsewhere reductions are made on proof that the annual value has diminished. Certain statutory allowances or deductions are permitted. Relief is granted under this schedule to the extent of an allowance of one-sixth of the annual value of houses and one-eighth of the annual value of lands in respect of the cost of repairs. A further allowance to owners of lands and houses is permitted in respect of the excess of the annual average expenditure for the five preceding years for the cost of maintenance, repairs, insurance, and management over the flat rate repairs allowance in the case of all lands and of houses the annual value of which does not exceed certain fixed limits. A remission of tax is also allowable in respect of any part of the year of assessment during which the houses are unoccupied. The annual value of colleges and halls in universities, hospitals, public schools, and almshouses is brought into assessment but the taxes are remitted, while certain classes of property are not assessed at all, viz. property vested in and in the occupation of the Crown, cathedrals, churches, etc. Certain concerns like railways, mines, gasworks, waterworks, docks, quarries, etc., which are akin to trading concerns, are included in Schedule A, but their annual value is measured almost entirely by the amount of profit under Schedule D. No assessment is made under Schedule A on the main premises owned and occupied by these concerns.

Income tax under Schedule B is charged in respect of lands occupied, and the assessment is made on a conventional basis which assumes that profits bear a relation to the annual value of the lands occupied. One-third of the annual value was taken as the basis of profits from 1896-97 to 1914-15, the annual value for the years 1915-16 to 1917-18, and from 1918-19 to 1921-22 twice

the annual value with certain exceptions. For the year 1923-24 the basis is equal to the annual value. The farmer occupying lands for the purposes of husbandry may be assessed on the conventional Schedule B basis, or he may elect to be assessed under Schedule D in the same manner as profits arising from trade. The profits of nurseries and market gardens are brought into assessment under Schedule B, but they are calculated according to the rules of Schedule D. The profits from the occupation of woodlands are also brought under this schedule, but the occupier managing woodlands on a commercial basis may request to be assessed under Schedule D.

Income tax under Schedule C—income from dividends or annuities from public revenue (Government stocks, etc.)—is collected at the source, the Bank of England or other agent making the deductions at the standard rate in force at the time of payment. There are a few exceptions to this. Most of the British Government securities issued during the War were either paid in full without deduction of tax at the source, and the interest was assessable on the recipient under the rules of Schedule D, or the interest paid on securities which are proved to be in the beneficial ownership of persons who are not ordinarily resident in the United Kingdom is not liable to tax. Some securities during the War period were issued on which income tax was compounded by means of a lower rate of interest. Interest on these securities is thus free from assessment to income tax although liable to super tax. War Savings Certificates and National Savings Certificates which are issued subject to a limitation on the total amount of the certificates that may be held by any one individual carry accumulated interest at the date of their maturity and are free from income tax and super tax in respect of that interest. Small sums under £2 : 10s. payable through the Bank of England out of any public revenue are not taxable at source, but are assessable on the recipient under the rules of Schedule D.

INCOME TAX UNDER SCHEDULE D

Trades, professions, remittances from abroad, interest, etc., are grouped under six heads or cases :

- I. Profits of trades, manufactures, adventures or concerns in the nature of trade.

- II. Income from professions, employments, or vocations (excluding employments which are assessable under Schedule E).
- III. Interest paid in full and assessable directly upon the recipient, including interest on certain British Government securities.
- IV. Income from Dominion and foreign securities (except that from Government securities chargeable under Schedule C).
- V. Income from Dominion and foreign possessions.
- VI. Profits from sources not falling under any of the foregoing cases or under any other schedule.

As already explained, railways, ironworks, mines, canals, docks, quarries, etc., are included under Schedule A, but chargeable according to the rules of Schedule D, and are dealt with for statistical purposes under Schedule D. Schedule D is by far the most important of the five schedules, and it constitutes the great problem of income-tax administration. The profits of professional men are in the aggregate small as compared with those of trades, and their returns are on the whole made with care and accuracy. The returns in respect of trade profits represent about one-twentieth of the whole body of taxpayers, but they pay approximately half of the total income tax. In recent years considerable attention and care have been bestowed on obtaining returns as accurately as possible of profits from trade. Trade profits are taken to mean the difference between the gross receipts and the expenses incurred wholly for the purpose of business, *i.e.* excluding deductions in respect of capital charges, lost capital, losses unconnected with the business, and private and domestic expenses. The following expenses may not be deducted under the system of collection at the source although they may be normally looked on as commercial expenses: annual interest on borrowed money, annuity, or other annual payment payable out of profit and any royalty in respect of patents; debts which are proved to be of a doubtful nature, debts which are proved to be bad, and any excess profits duty or corporation tax which has been paid in respect of the business are regarded as expenses incurred exclusively for the purpose of the business. The net amount upon which tax has been paid under Schedule A in respect of lands and buildings owned by the trader and occupied for the purposes of his business is also deducted in arriving at the profit, in order to avoid a double charge of tax on that part of the total

profit of the business. An allowance is made under Case I. of such an amount as the Commissioners may decide to allow for diminution in value by reason of wear and tear during the year of assessment of any machinery or plant used by the trade and owned by the trader. A reduction is made in respect of replacement of obsolete machinery. A reduction in respect of wear and tear of buildings which are used by their owner as mills, factories, etc., is allowed up to one-sixth of their value. The reduction for wear and tear is based upon the average of the profits of the three preceding years, and deductions for the replacement of obsolete machinery and for wear and tear of buildings are made not from the average profits but are regarded as items of expenditure in the calculation of the annual profits. In payment of interest, royalty, etc., the income tax may be deducted at the standard rate of tax by the trader, so that he recovers the tax relating to that part of the profits paid away to other persons.

The basis of the assessment for income tax is the average of the three preceding years¹ and this also applies to income from professions, vocations, and employments (excluding earnings of certain weekly wage-earners and assessments under Schedule E). As already noted, manual wage-earners are charged upon the basis of the actual year of assessment, but the assessment and the tax are collected quarterly in respect of the wages of the quarter and not annually on the wages of the whole year. From 1922 to 1923 all employees such as employees of individuals or partnerships are assessable under Schedule E instead of D and E as hitherto. Income from Dominion and foreign securities (Case IV. above) is also based on the year of assessment, while profits of railways, ironworks, gasworks, canals, docks, quarries, etc., in the United Kingdom and income from interest, discounts not taxed at the source, including interest on certain British Government securities, are calculated on the preceding year basis of assessment. Profits of coal mines, tin mines, iron mines, etc., in the United Kingdom are calculated on the average of five preceding years. Income from Dominion and foreign possessions other than securities is brought into assessment on the average of the three preceding years. Schedule D thus includes income from manufactures, railways, professions, employments, and interest on War securities

¹ The Royal Commission recommended that the preceding year should be the basis; *vide* p. 105, Report (Cmd. 615 of 1920).

not taxed at source. The percentage of each head to the total is as follows :

GROSS INCOME FROM SCHEDULE D IN 1920-21

Income from				Percentage to Total.
Manufactures	.	.	.	22
Railways, etc.	.	.	.	21
Professions	.	.	.	7
Employments	.	.	.	43
Interest on securities	.	.	.	7
Total				100

Income tax under Schedule D is, it will be seen, charged on the annual profits arising or accruing to any person residing in the United Kingdom from property wherever situated, but not assessed under Schedule A, or from trade, profession, employment, or vocation wherever carried on, and to any person not resident in the United Kingdom from property in the United Kingdom not assessed under Schedule A, or from any trade, profession, employment, or vocation exercised within the United Kingdom, and also from all interest of money, annuities, or other profits not charged under any other schedule and not specially exempted from tax.

Income tax under Schedule E is charged on individuals in the service of Government, of public bodies, and of limited liability companies, and, as already noted, from 1922-23, all employments. The amount brought into assessment is, generally speaking, the full salary or other emoluments of the year of assessment, but in the case of variable salaries it has commonly been the practice to assess on the basis of the earnings of the year preceding the year of assessment. Expenses wholly, necessarily, and exclusively incurred in the performance of his duties by an employee are deductible in arriving at the amount of the salaries assessable.

METHOD OF ASSESSMENT AND COLLECTION

4. It is necessary to go into the question of administration in some detail, because much of the success of the income tax depends on its administration. The income tax of Peel introduced in 1842 took as the unit of area the county division. Local and unpaid Commissioners for each county were appointed, and these Commissioners appointed assessors, made assessments,

heard appeals, certified to the Treasury authorities the amounts of duty they had charged, appointed collectors, examined the collectors' accounts, and certified amounts that for any reason remained unpaid. The local representative of the Crown corresponding to the Inspector of Taxes had the powers of inspection, objection, and surcharges. In course of time, however, the exercise of the theoretical powers of the Local Commissioner were transferred to the Inspector of Taxes, and the recommendations of the Royal Commission of 1920 were mainly directed towards the giving of legal sanction to the practical developments in the working of the tax.

The Board of Inland Revenue are by statute specifically entrusted with the "care and management" of the income tax. They control the Inspectors of Taxes and secure general uniformity of procedure by prescribing the forms that are to be used for income-tax purposes and making arrangements that are applicable to the tax as a whole, and ensure the consistent and continuous application of the machinery of local administration through their inspectors in association with the Local Commissioners, and draw the attention of Local Commissioners to new legislation. The work of bringing under review annually the financial position of 6,000,000 of people for determining the amount of income tax to be paid by them and the control necessary to accomplish this end are most efficiently done. The Royal Commission suggested that the Inspectors of Taxes should no longer be appointed by the Treasury but by the Board of Inland Revenue itself, as they work under and are directly responsible to the Board.

The General Commissioners are an unpaid body of men, usually seven in number, selected from among the Land Tax Commissioners. They are sometimes known as the Commissioners for the general purposes of income tax. In theory they are responsible in their respective divisions for the assessment and collection of the tax and they are independent of the Board of Inland Revenue. Everything that is not specifically directed to be done by some other authority was to be done by the General Commissioners, although by statute the income tax is under the "care and management of the Board of Inland Revenue". In practice, generally, the Commissioners confine themselves to the hearing of appeals, but few disputes go to them for decision, as

most of them are settled between the taxpayers and the Inspectors of Taxes. The Report of the Royal Commission shows that in twenty-two divisions the number of appeals actually heard by the Commissioners was 1263, although the number of assessments adjusted was 67,796, the remaining 66,533 cases being settled between the taxpayers and the Inspectors of Income Taxes. The General Commissioners are specially fitted for the hearing of appeals in normal cases by reason of their local knowledge, and in cases involving difficult questions of Law and Accountancy a motion might be forwarded to what are known as the Special Commissioners. The Additional Commissioners are an unpaid body of persons appointed by the General Commissioners for the division, and are independent of the Board of Inland Revenue. Their duties are to consider the returns made by taxpayers for assessment under Schedule D. In some cases the General Commissioners are to act as Additional Commissioners, but the General Commissioners who have actually made the assessments are not allowed to hear the appeals against assessments. In Ireland there are no Additional Commissioners, their place being taken by the Inspectors of Taxes. While the General Commissioners, of course, deal with Schedules A, B, and E, the Additional Commissioners are appointed by them for making assessments under Schedule D, and they are also a body of unpaid men intended to make use of their local knowledge for making proper assessments. The Special Commissioners are whole-time officials composed of experienced Inland Revenue officers and lawyers. The members of the Board of Inland Revenue are *ex-officio* Special Commissioners, but they do not take an active part in the latter's work. The functions of the Special Commissioners are to assess under Schedule D taxpayers who prefer not to be assessed by the Local Additional Commissioners, to hear appeals against Schedule D assessments, to administer the super tax, to assess the railways, to collect income tax from foreign and colonial dividends, and deal with repayments of income tax, etc. They are a centralised body in London, but go on circuit in order to dispose of appeals. The Royal Commission recommend that the Special Commissioners should continue to be appointed as at present, but that new appointments should be made only from amongst practising barristers, solicitors, or chartered or incorporated accountants of not less

than ten years' standing, and Civil Servants with considerable Inland Revenue experience ; members of the last-named class not at any period to exceed one-half of the number of Special Commissioners. The Commission was also of opinion that the Special Commissioners should be divested of the bulk of their administrative work and their activities restricted mainly to the judicial side, that is to say, to make them an appellate tribunal and little else. The Commission suggested that a central assessing authority should be set up, composed of Senior Revenue Officials nominated by the Board of Inland Revenue. This body should take over the assessing duties of the Special Commissioners. Any appeal from an assessment made by the Central assessing authority should be heard by the Special Commissioners. A Clerk is appointed to the General Commissioners as a part-time official generally working for the General as well as Additional Commissioners. The Clerks to the Commissioners are solicitors appointed by the General Commissioners. They act as legal advisers to the Commissioners, perform certain secretarial duties, and do clerical work in connection with assessment and collection. The Assessors, as their name implies, do the work in connection with the issue of forms of return for assessment, but the more technical part of the work is done by the Inspector of Taxes, until recently called Surveyor of Taxes. The Inspector of Taxes is in practice the pivotal figure in the income-tax administration. His detailed knowledge of income-tax law and practice in all its intricacies has rendered him eminently fit for discharging the functions assigned to the Commissioners by statute. In theory he has only the power of inspection, objection, and surcharge. In practice, however, he wields many of the powers vested in the Commissioners.

In 1923 a Rating and Valuation Bill was prepared in order to have one valuation for both rates and taxes, to enlarge the areas of assessment from a parochial basis to an urban, rural, and district or county basis, and to remedy some of the present anomalies. The case for the Bill is that reform is desirable as regards (1) the simplification of the rating system ; (2) the consolidation of rates ; (3) an equitable method as to precepts ; (4) a single, uniform quinquennial valuation for rates and taxes ; and (5) making the assessment committees more representative of different interests. The objects of the Bill are to have one

valuation for the national tax and local rates, and also to avoid duplication of work. The Local Commissioners will hear appeals, and the areas of administration will be distributed according to population and means of communication. The Bill, however, is objected to on the grounds that it increases the powers of the central authority, that it will increase local rates, that it is not economical, and that it does not really reduce the number of local areas of administration. It should, however, be remembered that the official is not entrusted with the task of valuation and assessment, and that he will have only rights of criticism, objection, and appeal. In fact, the Treasury is running the risk of substituting the extraordinary vagaries of rating practice for the present system. It has also been criticised from the point of view that a national tax must not be placed under the control of different local bodies.

BRITISH DOMINIONS

5. In the British Dominions the income tax follows mainly the principle that is followed in the mother country. The Canadian income tax was imposed in 1917. It provided for two rates of exemption, \$2000 as the minimum taxable income in the case of unmarried persons and widows and widowers without children, and \$3000 in the case of other persons. In the same year a super tax was also imposed. The rates of taxes were changed in 1918, 1919, and 1920. In 1918 a surtax was introduced in addition to the income tax and the super tax. The surtax was calculated as a percentage of the combined total of the income tax and the super tax. For example, a person with an income of \$7000 would pay income tax at 4 per cent, super tax at 2 per cent on the excess over \$6000, and surtax amounting to 5 per cent of the income and super taxes. Corporations were not liable to either super or surtax.¹ In 1920 shareholders' bonuses were brought under the tax. In 1921-22 the yield of the income tax approximated to three-fourths of the yield from customs.

In Australia a Federal income tax was introduced in 1915-16, State Governments having already in many cases an income tax of their own. The most important features of the Australian

• ¹ P. 654, *The Canada Year Book*, 1921.

taxes are : (1) the presence of income tax combined with land tax, *i.e.* the taxation of agricultural income together with the taxation on lands ; and (2) the higher taxation of absentees. In the Commonwealth of Australia income tax was introduced at different dates in the States, the Commonwealth income tax being introduced, as we have seen, in 1915-16. Widely divergent in the different States are the rates and exemptions, although the general principles regarding the same are similar. The Report¹ of the Royal Commission on Taxation in Australia deals exhaustively with this subject.

In New Zealand absentees pay the full rate of income tax without any deductions. The maximum deduction on account of life insurance is 15 per cent of the income as against 16·7 per cent in India. The principle of differentiation was introduced only in 1920. One important feature of the New Zealand income tax is that companies are also liable to a graduated tax. The Committee appointed to inquire into the taxation of the Dominion of New Zealand in 1922 condemned this as a penal rate far beyond any other in the British Empire. Super taxes are levied both in Australia and New Zealand.

In South Africa incomes are taxed by the normal tax, the super tax, and the dividend tax. In the normal tax the rates generally differ between persons and companies, but companies wherein (1) not more than ten of the largest shareholders hold 90 per cent of the shares, (2) restrictions are imposed upon the right to transfer shares, and (3) no invitation has been issued to the public to subscribe for any shares or debentures, are charged at the rate applicable to persons other than companies. For purposes of normal tax companies are allowed no abatement. Deductions allowed to other persons are proportionately reduced when the period taxable is less than a year, with due regard to change of circumstances caused by marriage, divorce, widowhood, etc. From the amount taxable under super tax losses and outgoings other than of a capital nature are deducted. The dividend tax is levied at the rate of 1s. 6d. per £ in the case of companies whose principal business is gold or diamond mining, and at 1s. per £ in the case of other companies. Companies

¹ Five volumes, No. 147-C. 9234 of 1921, F. 1345 of 1922, No. 35-C. 12364 of 1922, F. 12011 of 1922, and F. 18112 of 1923. (Government Printer, Victoria.)

which are charged with normal tax at the rate applicable to persons other than companies are not liable to dividend tax.

INDIA

6. The Board of Central Revenue has recently been entrusted with the administration of the tax, which is a central and not a provincial head of revenue. The Central Government will now devote much more attention than hitherto to the question of income tax. There is, however, as we shall see, a good deal of evasion. There is, for example, the question of one-person companies. This will be referred to in the discussion on evasion. The present Act is a great improvement on its predecessor, but still falls considerably below the Consolidated English Act. This, however, will be rectified as time goes on.

In India there were, before the introduction of the income tax (which took effect for five years from 31st July 1860), assessed taxes, which were taxes upon individuals in respect of their incomes or means of livelihood. These taxes on professions were abolished in Bengal in 1836, in Bombay in 1844, and in Madras in 1860. On account of the financial stringency brought about by the Mutiny, that distinguished financier, James Wilson, introduced a tax at the rate of 2 per cent upon incomes between Rs.200 and Rs.500 a year and 4 per cent upon incomes above Rs.500. Of this 4 per cent 1 per cent was apportioned to roads, canals, and other productive works. This was applied to all incomes, including agricultural incomes, except to those of the naval and military forces. It included income from investments as well as trades and professions. Landowners whose rent value was less than Rs.600 a year were exempt. The assessment was intended to be an annual one, but for the next four years the original assessment was maintained. A licence tax on trades and professions was imposed in 1867 and 1868 in place of the income tax. In 1869 the income tax was reintroduced first at 1 per cent, and subsequently increased to $1\frac{1}{2}$ per cent in the same year. This was again raised to $3\frac{1}{2}$ per cent. In 1870 the percentage rate was abolished, following the English practice, and the tax was levied at 6 pies in the rupee. This change in method, however, made little difference. In 1871 the tax was reduced from 6 pies to 2 pies in the rupee, and the taxable limit was

raised from Rs.500 to Rs.750 a year. The limit was raised to Rs.1000 in 1872, but the tax was not renewed in 1873. The licence tax was revived in 1877, and continued with variations up to 1886, when Government had again recourse to an income tax. Act II. of 1886 taxed incomes from all sources except agriculture. The exemption limit was Rs.500 ; up to Rs.2000 the tax was 4 pies in the rupee, and above Rs.2000 it was 5 pies. Act XI. of 1903 made the minimum taxable income Rs.1000. In the general scale of increased taxation imposed in 1916-17 to meet the deficit resulting from abnormal war conditions the income tax was completely revised, raised, and graduated. The taxation of income in India is at present governed by the Indian Income Tax Act of 1922 (Act No. XI. of 1922), as amended by provisions regarding rates of taxation contained in the Finance Acts of subsequent years. Assessments are no longer made on different sources of income but on all sources combined. The following varieties of income are not taxable, viz. income from property held under trust for religious or charitable purposes, income of religious and charitable institutions and of local authorities, commutation of pensions, legacies, and casual receipts. One special feature of the Indian income tax is that agricultural income is not chargeable to income tax. The effect of this provision in a country 71 per cent of the population of which live by agriculture may very well be imagined. The classes of income chargeable to income tax are six, viz. salaries, interest on securities, income derived from property (mostly houses), income derived from business, professional earnings, and income derived from other sources, excepting those specially exempted. In computing the income assessable to income tax certain deductions are made as in Great Britain. For example, although salaries are taxed, special allowances "granted to meet expenses wholly and necessarily incurred in the performance of the duties of an office" are exempt from taxation. From the income derived from house property one-sixth of the annual value is deducted on account of cost of repairs, as also insurance (fire) premia, interest on mortgages, land revenue, collection charges, and vacancy allowances. In arriving at the income derived from business, also rent for the premises, cost of repairs, interest on borrowed capital, risk insurance premia, depreciation, wear and tear charges in respect of plant and machinery, land revenue,

and expenditure from revenue are allowed for. In the case of every company and registered firm the rate of tax is one anna and six pies in the rupee whatever its total income, but this is subject to abatement, or exemption in the case of individual shareholders who can show that their total income is such as to warrant a lower rate of taxation than this amount (one anna and six pies) or none at all. Professional earnings are assessed only after deducting necessary (but not personal) expenses. The general exemption limit is Rs.2000 in India, with effect from 1st April 1919, but incomes of Rs.2000 and over are liable to income tax on the whole amount and not on the surplus above an exemption limit only.

In India graduation is effected mainly by varying the rates of tax leviable on different incomes according to their size. The rates in force at present vary from 5 pies to one anna and 6 pies in the rupee. When the total income is Rs.2000 or upwards but is less than Rs.5000 the rate is 5 pies in the rupee, when it is Rs.40,000 or upwards the rate is 1 anna and 6 pies in the rupee. The principle of differentiation is not followed except perhaps in regard to companies or firms which are taxed at the maximum rate. Rebate is granted in respect of life insurance premia, subject to the maximum of one-sixth of the assessee's total income. The principle of the assessee's making their own individual returns and of taxation at the source are followed. The basis of assessment is usually the preceding year.

A Super-tax Act was passed in 1920 under which super tax is payable in addition to income tax, and is levied on a graduated scale on so much of the income as is in excess of Rs.50,000 per annum. This Act was repealed and replaced by Act XI. of 1922. The tax levied during 1924-25 varied from 1 anna to 6 annas in the rupee. In the case of a Hindu undivided family super tax is payable on incomes in excess of Rs.75,000 only. In the case of every company, however, a flat rate of 1 anna in the rupee is levied as super tax on all incomes above Rs.50,000.

As already pointed out, income tax is a head of central revenue in India. Rule 15, however, of the Devolution Rules allocated 3 pies on each rupee in excess of a certain datum line in respect of which income tax has been collected within its jurisdiction to each local Government. It may be possible in future to meet the demand for additional revenue on the part of local Govern-

ments by a supplementary levy on income tax as in Australia and in France. From 1st April 1922 for every rupee of income assessed to the tax over and above the income assessed in 1920-21 the Provincial Governments receive 3 pies. Under this system they are not benefited by any increase in the rate of income tax. Nor do they receive any share in the super tax. If Rs.50 crores were assessed to income tax in 1920 and Rs.60 crores in 1923 the Provincial Governments would be entitled to 3 pies on Rs.10 crores. If, on the other hand, the rate of tax alone were enhanced and the income assessable to tax remained stationary at Rs.50 crores the Provincial Governments would not get anything.

UNITED STATES

7. In the American Colonies before the middle of the seventeenth century there was a tax on gains and profits derived from personal ability as distinct from property. Until 1861, however, no general tax on income was in use in the United States. The Civil War, however, necessitated the introduction of the tax, which taxed incomes upwards of £160 at the rate of 3 per cent. The rates of tax were subsequently increased until the tax was dropped in the year 1872. In 1894 the rate was 2 per cent with an exemption limit of £800 or 4000 dollars. The tax was declared unconstitutional and withdrawn,¹ but the demand for income tax greatly increased, until on 25th February 1913 the foundation for the Federal system of income tax was laid. In addition to the Federal income tax there is an income tax in the States of Wisconsin, Massachusetts, Connecticut (corporations only), New York, Oklahoma (personal incomes only), West Virginia (corporations only), Missouri, Virginia, Delaware (personal incomes only), North Dakota, North Carolina, and Montana (corporations only). The following table shows the most important characteristics of the Federal income tax since the pre-War year :

¹ Section 2, Article 1, of the American Constitution provides that "... direct taxes shall be apportioned among the several states according to their respective numbers". This led to the 16th Amendment of the Constitution, proposed by Congress on 31st July 1909 and proclaimed adopted on 25th February 1913, when it was ratified by the requisite number of States to make it a part of the Constitution. The 16th Amendment provides that Congress shall have power to lay and collect taxes on incomes from whatever source derived, without apportionment among the States and without regard to any census or enumeration.

PERSONAL INCOME TAX IN THE U.S.A.

	1913.	1920.
Total number of returns . . .	357,598	7,259,944
Total net income (millions) . . .	\$3,900	\$23,736
Total tax yield (millions) . . .	\$28	\$1,075
General average rate (per cent) . . .	1	4.53
Personal exemptions :		
To individual . . .	\$3,000	\$1,000
To head of family . . .	\$4,000	\$2,000
For each dependent . . .	..	\$200

Taxes on corporations which are not made on the basis of their income alone will be dealt with in a later chapter. In certain States there is no special system of corporation tax except the system of income tax. This is largely due to the unsatisfactory returns especially in intangible personal property. There is a growing tendency to levy the tax on the basis of the Federal tax, and attempts are made by apportionment devices to exempt business or corporation incomes derived from property located and business transacted outside the State. The most important characteristic of the Federal income tax is its productivity. Only a small proportion of the population is directly affected in industrial States. The rates are high on larger incomes as compared with other countries, and on smaller incomes they are low. Other characteristics are the high personal exemptions and the taxation of gains from the sale of capital assets. The tax, however, has a weak point in that it does not reach, for constitutional reasons, municipal bonds and other tax-free securities. No relief is allowed in the case of earned incomes, and excessive surtaxes have led to the investment of capital in tax-exempt securities. It is unwise on the part of a Government to levy taxes running up to 50 per cent (1924) of an individual's income while tax-exempt securities paying $4\frac{1}{2}$ to 5 per cent interest are available in abundance. Information at source has been substituted for collection at source. There are other criticisms of the working of the Act, for example, the deducting from the tax due from its citizens any tax paid by them on their income from abroad. This is made entirely at the expense of the investor's home exchequer. Some of the defects are already under consideration. On 10th November 1923 the Secretary of the Treasury, Mr. Mellon, proposed to remedy some of the shortcomings. He proposed to allow a reduction of 25 per cent in the case of earned

incomes. The surtaxes were to be reduced owing to the withdrawal of capital from new business and its diversion into tax-exempt securities. Mr. Mellon's plan, however, was not accepted by the Congress. The existence of State income tax in addition to the Federal tax has brought into prominence questions of jurisdiction, assessment, and multiple taxation. Some of the States which levy income tax pay a portion of the tax to county or local authorities.

JAPAN

8. Japan, it will be remembered, followed, within a year, India by introducing an income tax in 1887. The tax was altered in 1901, 1905, 1913, and 1918, but it was revised thoroughly on two occasions only—in 1899 and 1920. The three main classes of income taxed are income of corporations, income from securities, and income of individuals from salaries and other sources. Public corporations, industrial and fishery unions, and persons engaged in the agricultural warehousing business are exempt from taxation, as are also the salaries of Army and Navy officers while engaged in war, allowances to widows, orphans, the sick and the wounded, etc. In Japan the principle of graduation is brought into force by granting certain abatements for earned income, allowances for family responsibility, and variations in the rates of tax imposed. The income of corporations in excess of 10 per cent of the assets only is liable to tax varying from 4 to 20 per cent according to the percentage excess of profits. The interest on securities except those exempted is assessable from 4 to 7.5 per cent. There is no separate corporation tax in Japan besides the income tax. Earned income is differentiated by granting abatements ranging from 10 to 20 per cent of such income when the total income is below 12,000 yen per annum. Abatements in respect of family responsibility are granted only in cases where the total income falls below 3000 yen a year. The rates of abatement on account of family responsibility are variable according to the size of the income, and are granted in respect of non-earning members of the family under 18 or over 60 years and disabled or invalid dependants. The abatement varies between 50 to 100 yen per dependant according to the amount of income. Income tax is leviable on individuals only if the income after all these deductions are made exceeds 800 yen, or about Rs.1200.

Inclusive of the abatements the minimum liable to taxation comes to about 1250 yen, or approximately Rs.1900—a sum closely corresponding with the limit of Rs.2000 in India. The tax on the income of individuals is graduated from 0·5 to 36 per cent according to the size of the taxable income. Thus on incomes exceeding 800 yen but falling below 1000 yen the tax is 1 per cent, and on incomes exceeding 4,000,000 yen it is 36 per cent. The income tax from Class I. is collected at the end of every business year, from Class II. at the source, and from Class III. in four equal instalments payable on 30th September, 1st November, 1st January, and 1st March. The tax of Japan bears a family resemblance to that in India. The tax differs, however, in two main respects from the taxation in India : (1) the income from land is taxed, and (2) the income of certain companies like iron foundries is exempt from taxation under the Iron Foundry Encouragement Law. It is also provided that for those who are manufacturing staple commodities as specified by Imperial ordinances the tax is wholly remitted for three years from the year of starting business, and from the fourth year it is partially remitted from their incomes derived from the business as determined by order.

INCOME TAX IN FRANCE

9. The main features of the French income-tax system have been referred to in paragraph 8, Chapter XIV., on the Distribution of Central, Provincial, and Local Revenue. The income tax of France falls under two heads, viz. the general income tax and the scheduled taxes. The general income tax is graduated and is levied on taxable incomes exceeding 6000 francs. The rate of tax is 50 per cent, and is levied on one twenty-fifth of the taxable income between 6000 and 20,000 francs, two twenty-fifths of that between 20,000 and 30,000 francs, and so on increasing by one twenty-fifth for each 10,000 francs up to 100,000 francs, then for each 25,000 francs up to 400,000 francs, then for each 50,000 up to 550,000, and then the whole of the excess. Unmarried or divorced persons without dependants and married persons over thirty years without children are taxed at a higher rate. The scheduled taxes are levied on industrial, commercial, and agricultural profits and incomes of professions and employments. The war profits tax of 1916 was abolished in 1920. There is also a tax upon the

income from transferable securities. The income from mortgages is subject to taxation.

It is not possible to deal with all the income-tax systems in detail that are in vogue in other countries owing to reasons of space. The German system of State income tax will be found in Chapter XXXII. on Local Taxation.

CHAPTER XXII

THE TAXATION OF INCOME (GENERAL PRINCIPLES)

1. WE have seen in the preceding chapter that the income tax as levied in most countries extends to the income of individuals and also companies, corporations, and other bodies or persons who are resident in the country, or who receive income which arises in that country. This may be taken as the general rule. It extends not merely to income arising in the country, but to all incomes accruing to the person resident in the country, without regard to the place where it may arise. In Great Britain and certain other countries income is classified according to its source; for example, profits in Great Britain have been divided into the following five classes, viz. (*a*) profits from ownership of lands and buildings, (*b*) profits from the occupation of lands, (*c*) profits from invested public funds, (*d*) professions and employments, and (*e*) profits from emoluments of public office.

We shall now deal with some of the more difficult problems underlying the income tax. Most, if not all, of these have already been referred to in the descriptive portion of the previous chapter. For convenience we shall first deal with the scope of the tax, graduation, differentiation, abatements, collection at the source, the period on which the tax should be calculated, and lastly, the all-important question of evasion.

SCOPE OF THE TAX

2. The taxation of income usually affects non-residents as well as residents, but not in all cases. It is customary, as has been shown, to tax residents on their income arising inside and outside the country, and non-residents on income arising inside

the country. In the case of companies residence is determined according as the direction of control is centred in Great Britain or abroad. Non-residents may in the case of Great Britain and Northern Ireland recover income tax from interest and colonial securities, and also certain British War loans. Although non-resident, they have to pay income tax on income arising in the United Kingdom such as income from industrials, railways, and banks. British subjects ordinarily resident outside Great Britain and Northern Ireland are entitled to reliefs in the form of abatement and allowances to which those resident in Great Britain and Northern Ireland are eligible. Other non-residents are liable at the full standard rate without allowances and reliefs. The British Revenue authorities have recently interpreted more strictly than hitherto the law in regard to residence. The taxing authorities now have to be certain that not only has the taxpayer abandoned his British residence, but that he has actually established a definite residence abroad. Thus in the words of a memorandum ¹ of the Board of Inland Revenue, London, "a British subject, whose ordinary residence has been in this country, notwithstanding that he may reside abroad for more than six months of the income tax year, remains chargeable to British income tax for that year as a person resident and ordinarily resident in this country, unless he has gone abroad in such circumstances that he cannot be said to have left this country for the purpose only of occasional residence abroad". Thus civil servants from India and the Colonies residing in Great Britain for less than six months and establishing no residence are not liable to British income tax on income arising abroad, and they therefore enjoy the relief according to non-residents. An English visitor to Cannes, however, who spends six months abroad, but is unable to show that he is ordinarily resident abroad like the civil servants above, would be liable for tax. Under the British system a man, for example a civil servant of India or the Colonies, is regarded as resident in Great Britain in any year that he lives in the country if he has a house or dwelling for his occupation, although his visit be of a few days' duration, say to see his wife and family. The British Royal Commission on the income tax has recommended that all remittances from a husband

¹ Circulated to bankers, etc., in Great Britain and North Ireland in January 1924.

abroad to his wife in Great Britain should be chargeable to income tax.¹

Should money income or real income be taken ? Clearly real income should be taken, but it is extremely difficult to evaluate, and as a rule money income is taken except in the case of lands and houses. The British Royal Commission recommended that when part of the regular remuneration is in kind it should be brought under assessment. Speaking generally we may say that while it is possible to value the letting value of a house in which the owner lives and to tax him accordingly, it is not feasible to extend this, except mainly to houses and lands. Then, again, there are the distinctions between gross and net income and between income and capital. While the taxation of net income is the ideal, it is only possible, as we shall shortly see, to allow for those expenses immediately connected with the work from which the income is obtained. In regard to the distinction between income and capital it may be said that, the tax being an income tax, no account should ordinarily be taken of losses or gains of capital. The practice of allowing for wastage which is unavoidable in the production of income is customary, and rightly so.

Bonus shares arise from capitalising profits of the current year or the undistributed profits of previous years, the increased value of capital assets or the gains on the sale of capital assets. The profits of the current year or the undistributed profits of previous years are already taxed before conversion into capital, and therefore to tax them again as bonus shares seems unfair, notwithstanding the increased standard rate of tax in the subsequent year. In a recent case² the House of Lords decided that a resolution of a company converting into capital what was originally income is "good as against the whole world, including the Crown, claiming or taxing for any other purposes". Bonus shares arising from the increased value of capital assets or the gains on the sale of capital assets are usually exempted from taxation because they are of capital origin.

The taxation of non-recurring or occasional profits arising

¹ *Report of the Royal Commission*, p. 7, Cmd. 615, 1920 (H.M. Stationery Office, London).

² *Commissioners of Inland Revenue v. Blott*, *Times Law Reports*, vol. 37, No. 26, 17th June 1921.

from transactions that do not form part of the ordinary business of the person who makes them has sometimes been held to be outside the scope of the income tax. Any profit, however, made on a transaction in which the subject matter was acquired with a view to profit should be assessed to income tax and not treated as an accretion to capital. Thus speculation, betting, gains from company promotion, and occasional cash sales would be liable to income tax. It is sometimes argued that casual profits should not be taxed because of the extreme difficulty in tracing transactions and in preventing evasion. With increased efficiency in administration this difficulty should not be altogether insuperable.

GRADUATION

3. Twentieth-century legislation has accepted the principle of graduation almost without exception as a characteristic of the tax. Graduation means the levying of a heavier percentage upon large incomes than upon small incomes, and deprecates the principle of the universal flat rate of tax applicable to all incomes regardless of their size. There may be graduation downwards by reduction of the standard rate to lower incomes, and upwards by means of an additional income tax chargeable as super tax, or surtax as Americans call it. In other words, as the Select Committee on Income Tax of 1906 pointed out, there are three possible ways of effecting graduation, viz. (1) a graduated rate of tax according to the total net income of the individual, (2) a super tax, *i.e.* a tax supplementary to and distinct from the income tax leviable on individuals by direct personal assessment, and (3) graduation by degression, which might take the form of extending the system of abatements or charging a lower rate of tax on lower incomes. It is sometimes said that the first of these is likely to lead to the abandonment of the principle of taxation at source, and the second is practicable although subject to some of the inconveniences of the first, and that the third is convenient but within certain limits only. The Royal Commission of 1920 recommended that graduation should be effected with reference to the size of the income solely by a variation of the real effective rate of tax. The principle of graduation was known in ancient Greece, and in the mediæval poll tax in England. Pitt's "Triple Assessment" contained

elements of graduation confined to the lower ranges of income. The 1799 Act exempted incomes under £60 and charged incomes between £60 and £200 on a graduated scale of rates (at less than the full rate), and laid the full rate on incomes of £200 and over. In 1803 the full rate came into operation at £150, and in 1806 the exemption limit was reduced to £50. The 1842 Act had a certain amount of graduation owing to the fixing of a minimum exemption limit of £150. Gladstone's first Budget in 1853 fixed the exemption limit at £100, and an abatement of tax was allowed on incomes of less than £150. Gladstone, however, was no friend of the system of graduated taxation, and he said that it tended to communism. Even John Stuart Mill regarded graduated income taxation as graduated robbery. In the twentieth century, however, the attitude towards graduation completely changed, and a system of graduation in most countries was adopted by (1) abatement, (2) by a sliding scale of income-tax rates which formerly existed in Great Britain, and (3) by a super tax or "surtax". In India, for example, graduation is effected by the general exemption limit and the varying rates of income tax and super tax. In the United States varying rates are applied, not to the whole of incomes after deducting any general abatement, but to the slices of income lying between specified limits. This is also true of the super tax in the United Kingdom and in India. The method followed in the case of super tax is not applied to income tax, as it involves much trouble. The super-tax method is to tax each £ of the first £100 at so much, the second £100 at so much, and so on throughout. This method presupposes that the exact total income of individuals before assessment is known. The difficulty of obtaining this information for all the millions of incomes that have to be assessed constitutes an insuperable obstacle that stands in the way of the adoption of this method in preference to the present method. In the United States, however, this difficulty does not arise, as information at source has been substituted for collection at source. In the Dominions, mainly in Australia, New Zealand, and South Africa, the rate of tax charged changes with each small increase of the total income, subject to a maximum rate on large incomes. Briefly, the principle of graduation is based on the law of diminishing utility. The hurt caused by obtaining Rs.10,000 of additional

revenue by means of levies of Rs.50 from each of 200 incomes of Rs.500 is undoubtedly greater than that caused by taking it from one income of Rs.100,000.

DIFFERENTIATION

4. Although the question of differentiation dates from 1798 in the English income tax, it did not come into practice until 1907. It is interesting to note, however, from the point of general principles that this was considered over and over again by responsible authorities. A member of the House of Commons, for example, in December 1798¹ declared that "a man who had an income of £1000 per annum arising from capital, and the man who gained the same annual sum by a profession or by business, surely ought not to be assessed in the same degree". Pitt, however, considered that this was revolutionary, and said "to complain of this inequality is to complain of the distribution of property; it is to complain of the constitution of society. To attempt to remedy it would be to follow the example of that daring rabble of legislators in another country." The Select Committee of 1851 and also the Select Committee of 1861 considered this, but were unable to make any practical suggestion for differentiation in favour of earned income. To-day the expression earned income is sometimes known in the Dominions as income derived from personal exertion as opposed to income derived from property. In France the expression is "*revenu gagné*" or "*revenu le produit du travail*" as opposed to "*revenu provenant du capital*". In Italy the expression "*labour income*" ("*redditi di lavoro*") is used as opposed to "*redditi di capitale*", and in German phraseology ("*fundiert*") funded as opposed to unfunded income ("*unfundiert*"). Other terms sometimes used to indicate the distinction are "permanent" and "precarious", "spontaneous" and "industrial", "unearned" and "earned", and "investment" and "earned income". Of these the term "unearned" is objected to as casting a reflection on income from investments. The Royal Commission of 1920 has, therefore, recommended the adoption of the term "*investment income*" in place of "unearned income". It is sometimes said that the distinction between earned and invest-

¹ Mr. Hobhouse, pp. 24-25 of Hansard, vol. xxxiv., 3rd Dec. 1798.

ment income is inappropriate, as it is hard to define and excludes many cases of mixed incomes. That may be so, but the distinction is only a working solution of a difficult problem, and it does not penalise thrift and economy and entail a loss to the State owing to the exemption of persons with low unearned incomes. Investment income is independent of the existence of the investor, while income from professions, trade, etc., depends on the worker's healthy life. The worker is, moreover, tied down to a place and cannot move about like a large investor. The difference between earned and investment incomes is very well brought out by the Secretary of the U.S.A. Treasury, in his letter to Congress dated the 10th November 1923. He says: "The fairness of taxing more lightly incomes from wages, salaries, and professional services than the income from a business or from investment is beyond question. In the first case the income is uncertain and limited in duration; sickness or death destroys it, and old age diminishes it. In the other the source of income continues; it may be disposed of during a man's life and it descends to his heirs." There is, therefore, a substantial difference between the two classes of income, and the continuance of the distinction is highly desirable. In Great Britain the hardship of persons with small unearned incomes has been mitigated to a large extent by the abatement of one-tenth of the earned income subject to a maximum of £200, which was recommended by the Royal Commission of 1920. Differentiation is, in short, a workable proposition. The taxation of property by means of estate or succession duties is often regarded as effecting a measure of differentiation in favour of incomes derived from personal exertion. The effects of this differentiation are generally undesigned, remote, uncertain, and little understood. Differentiation in favour of earned income is, as we have seen, made in Great Britain by the deduction of one-tenth of the earned income in order to arrive at the assessable income. This deduction is granted irrespective of the amount of the total income, but it must not exceed £200 for any one individual. By assessable income is meant the total income as computed for income-tax purposes after making the appropriate deduction in respect of any earned income. Taxable income, on the other hand, means that part of the assessable income upon which income tax is actually charged, or

assessable income less the various deductions such as personal allowance for self, increased personal allowance where wife has earned income, and deduction for housekeeper, children, and dependent relatives. In short, after the deductions for children, etc., are made, the balance is known as taxable income.

In Great Britain to-day (1924) taxable income is charged at half the standard rate up to a certain sum, viz. £225 whatever the total amount of income is, and on the remainder at the standard rate. The allowance for children is also, as we have seen, independent of the total amount of income. It may be mentioned here that care should be taken in reading income-tax statistics to differentiate between the aggregate gross income and the aggregate statutory income of those individuals above the effective exemption limit. The gross income exceeds the aggregate statutory income not only because of the inclusion in the gross income of certain individuals who are exempt, but also due to deductions made in the course of practical administration for depreciation and similar reasons.

ABATEMENTS

5. In addition to exemptions and deductions such as allowances for depreciation, wear and tear, there are also other allowances which have been permitted in recent years from assessable income. The personal allowances and deductions usually take the form of (1) a personal allowance, (2) an increased personal allowance where the wife has earned income, *i.e.* the personal allowance for the individual is higher in the case of a married man living with his wife than for a bachelor, (3) deduction for children. In Great Britain, for example, a personal allowance is allowed of £135 for a bachelor and £225 in the case of a married man whose wife is living with him. Where the wife has any earned income, the personal allowance of £225 is increased by a sum equal to nine-tenths of the amount of such earned income subject to a maximum additional allowance of £45. It is sometimes pointed out that the system of "pooling" for income tax and super tax the separate incomes of husband and wife, with the illogical and inequitable result that the aggregate demand upon them is thereby increased, is in fact

a tax upon matrimony. There is no similar pooling when a brother and sister or two or more bachelors or spinsters live together in one establishment and share the expenses; the married couple, very probably with children to provide for, may be said to have a greater rather than less claim for consideration and for the removal of this invidious distinction. Although pooling leads to an unfair taxation of married couples, it is not a deterrent to matrimony. This consideration does not influence anybody in solving the problem "to marry or not to marry". The married woman's status should be no less than her single sister's, especially as the law has ceased to regard the individuality of the wife as merged in that of her husband. Government cannot afford to remove this distinction unless individual incidence is correspondingly revised. The separate assessment of husband and wife would result in a loss of £35,000,000 to the British revenue annually. That the revenue will suffer if the husband's and the wife's incomes are taxed separately cannot, of course, justify an unjust law, but equity is not the final determining consideration in public finance and is not so important as productivity. In favour of the present system it may be urged that in actual life the incomes of the majority of married people do constitute a common purse, that a married couple spend less than two persons living separately and consequently have more tax-paying ability, and that a system of separate assessment would result in an invidious distinction between married couples according as the total income is entirely contributed by one of the spouses or equally by both. In the former case the tax would be high and in the latter less. Income may otherwise be so transferred between husband and wife as to reduce the rate on such income to a minimum. In Great Britain a deduction is permitted in respect of one child of £36, and £27 in respect of each additional child for whom the relief is due. No deduction is, however, allowed in respect of any child or adopted child receiving an income of its own exceeding £40 a year. (4) In rarer cases deductions for a housekeeper, dependent relatives, etc., are allowed. The method by which the abatements in Great Britain are made may be illustrated in the table on following page :

INCOME TAX—SCHEDULES A, B, C, D, AND E.

Assessments made in 1920-21.

Items.	United Kingdom. £ (millions).
(a) Gross income	<u>3477</u>
(b) Exemptions :—	
Incomes below the effective exemption limit	81
Charities, colleges, hospitals, schools, friendly societies, etc.	23
Dominion and foreign dividends belonging to persons not resident in the United Kingdom	4
(c) Reductions :—	
Repairs—lands and houses and buildings	47
Empty property	2
Wear and tear of machinery or plant	52
Other reductions and discharges	607
Total (b) and (c)	<u>816</u>
(d) Actual income (viz. gross income (a) less exemptions (b) and reductions (c))	2661
(e) Earned income allowance (one-tenth)	<u>157</u>
(f) Assessable income (viz. (d) minus (e))	<u>2504</u>
(g) Personal allowances, deductions, and reliefs :—	
Married persons, £225	754
Other persons, £135	327
Allowance in respect of wife's earned income (max. £45)	3
Relief in respect of housekeeper	2
" " children	55
" " dependent relatives	7
Total (g)	<u>1148</u>
(h) Taxable income (viz. assessable income (f) less allowances (g)) :—	
(i) At half standard rate (3s.)	304
(ii) At standard rate (6s.)	1052
Total (h)	<u>1356</u>
(j) Tax chargeable thereon	361
(k) Allowances of tax in respect of life insurance premiums	5
Dominion income tax relief	3
(l) Net produce of the tax	<u>353</u>
(m) Net produce for each penny of the normal rate of tax (6s.) (i.e. one seventy-second of the total (l))	<u>4.9</u>
Average effective rate of tax levied on each pound of actual income (d)	2s. 8d.

The underlying principle in the case of abatements on insurance premiums is the mitigation of the taxes that are encroachments

upon savings, and in the case of allowances for wear and tear, depreciation and obsolescence of plant and machinery, the tax is charged on the net income rather than gross income as far as practicable. To the case of family responsibility some regard is paid. The married man with or without children and the bachelor are never on the same footing, as it is obvious that a bachelor can afford to pay more than a married man. A general exemption limit for all incomes is fixed mainly for two reasons: (1) the cost of collection would be abnormally high if there were no such limit, and (2) it is not desirable to tax heavily those whose income is below or at the subsistence level. At the same time wages do contain a taxable element, and this, as will be seen in a subsequent chapter, is reached through mainly indirect taxes. It is desirable that the exemption limit when once fixed should not vary before the lapse of a considerable period, and it should be varied only when there is a very substantial change in the cost of living. It should not fluctuate from year to year and should be uniform for all classes, regardless of their conventional standards of living.

COLLECTION AT SOURCE

6. A great principle in income tax is, as far as possible, the collection at the source of income. It is not a universal principle, but it has attained a peculiar importance in many countries. The tax is deducted before the income reaches the person earning it. Thus when a person has shares in a limited liability company, the income which he derives is taxed at the full standard rate before he gets it. If the rate proves to be higher than he ought to pay, he can have this adjusted by claiming a refund. The companies' profits are always taxed at the maximum rate so that the revenue may not suffer in any way, and the burden of claiming refunds rests on the tax-payer. Assessment is made on each source of income by itself, and it simplifies the collection of the tax as a whole as well as increases its yield. At the same time it makes, as we shall see, graduation on total incomes far from easy. The persons who pay the tax sometimes deduct it from payments belonging to other persons. Thus in the case of rents arising from lands or buildings which are let it is to be paid in Great Britain by the occupier, who

in turn deducts it from the rent paid to the landlord. The landlord, if the property is mortgaged or subject to a ground rent, may deduct the tax from the amount which he pays. Similarly a limited liability company is assessed to tax at the standard rate on the whole of its profits without reference to the ultimate destination of those profits. On paying interest to its debenture-holders or dividends to its share-holders a company is entitled to deduct and to retain the amount of tax payable on the interest paid or dividend distributed unless it decides to pay dividend interests and debentures free of income tax. In this connection a considerable amount of income tax is paid very often which is not reclaimed from the authorities. Small investors who have placed their savings with companies are paid interest less income tax. They do not understand, or at least never claim, the right of refund, although they are not bound to pay any income tax.

The principle of stoppage at the source has been of immense benefit to the revenue in most countries and avoids the friction between the tax collectors and the tax payers which is otherwise liable to be engendered. The taxpayer feels least the burden of a tax which is deducted without the money actually passing through his hands. We have seen above that the 5 per cent tax of 1803 collected at the source yielded nearly as much as a tax of 10 per cent did in Great Britain during 1801 under the system of direct personal assessment. It is sometimes urged for purposes of securing a smooth graduation curve that the principle of taxation at the source should be abandoned. Smooth graduation requires the progressive adjustment of the rate of tax to the size of the income, *i.e.* without abrupt jumps or without proportional rates. This is somewhat difficult, although not impossible, under a system of collection at the source, since the total incomes of the individuals taxed are not known at the time of deduction at the source. As Sir Josiah Stamp well put it before the Royal Commission, "with no taxation at the source, and with a smooth graduation, a defective memory is doubly endowed; first, by the tax on the item omitted, and, secondly, by the reduced rate on the income shown".¹ These critics in favour of the abandonment of the principle of collection at the source may be answered

¹ Paragraph 9582 (12) (4), *Minutes of Evidence of the Royal Commission on the Income Tax*, 1919 (Cmd. 288, 3), p. 458.

in the words of Sir Josiah Stamp: "The wanton and bigoted way in which persons obsessed with certain mathematical ideas urge the sacrifice of all practical points to their lust for algebra would be a serious public danger if their influence became great. . . . We should as a people make a very bad bargain if we sacrificed the principle of taxation at the source for the doubtful boon and inconclusive virtues of a curve even of most elegant functions and unimpeachable suavity. Not one per cent of the taxpayers would be any happier or pay their taxes any more cheerfully for a logarithmic demand note."¹

If taxation at source were abandoned, each income taxpayer would furnish a return of his total income on which he would be taxed, and this would lead to smoother graduation by the adjustment of the rate of tax to the total income. At the same time smoother graduation can be obtained by retaining collection at source in conjunction with information at source. Both collection at source and information at source are used in the United Kingdom and in some other countries. Taxation at source should not be abandoned. If it were given up it would not be possible to get the correct total incomes of people above the exemption limit or below it, and in this and other ways the State would lose revenue. In four of the Australian States companies' profits are taxed at the full rates, but no rebates are allowed to the individual taxpayer who excludes his dividends from his returns of income tax. This apparently simple system is not on the whole a good one, because a man with an income of say £500 of which £250 is investment income is made to pay on half his income at the full rate, the remaining half being taxed at the rate appropriate to his income. In Great Britain the whole income (earned and investment) is included in the return, and the taxpayer receives rebates on that portion which has already paid income tax at the standard rate, viz. from dividend income. It is true that taxation at the source involves the collection of large sums of money which have subsequently to be refunded, thus depriving the taxpayer of the use of funds for various periods. Information at source makes the taxpayer meet the burden from the money which has already reached his pocket. He would feel the tax less had it been deducted from funds before these reached him.

¹ Paragraphs 9610 and 9611, *Minutes of Evidence of the Royal Commission*, 1920, vol. iii. pp. 463 and 464.

THE BASIS OF ASSESSMENT

7. Should the liability of the taxpayer be assessed on the income of the year of assessment, the preceding year, or the average of a series of years immediately preceding the year of assessment? The basis of assessment in Great Britain has already been dealt with under the different schedules.¹ It was shown that the year of assessment is taken as the basis for the earnings of weekly wage-earners employed by way of manual labour and also for the income from Dominion and foreign securities. The preceding year is taken as the basis for profits of railways, ironworks, gas-works, canals, docks, etc., and income from interest, discounts, etc., which are not taxed at the source, and also interest on certain British Government securities. The average of three preceding years is taken for profits of trades, manufactures, etc., and income from professions and employments (excluding the wages of certain weekly paid wage-earners). Income from Dominion and foreign possessions other than securities is also assessed on the average of three preceding years. The profits of coal mines, tin mines, iron mines, etc., are assessed on the basis of the average of five preceding years. The above periods are used for determining the amount of the statutory income and also the appropriate rate of tax, although the amount taxable and the rate applicable are two distinct ideas. The hardship caused by taking different years as water-tight compartments is illustrated in the report of the Royal Commission on Taxation² in Australia by the following table :

Year.	Pastoralist's Income.	City Man's Income.	Pastoralist's Tax to the Federal Government and N.S.W.	City Man's Taxes.
	£	£	£ s. d.	£ s. d.
First . . .	5796	960	1267 2 3	87 19 8
Second . . .	3800 (loss)	960	Nil	87 19 8
Third . . .	896	960	80 9 5	87 19 8
Fourth . . .	6700	960	1653 15 10	87 19 8
Fifth . . .	4790 (loss)	962	Nil	88 4 5
Total .	4802	4802	3001 7 6	440 3 1

¹ Chapter XX.² Vol. No. 147 of 1921, Government Printer, Victoria.

The injustice of taxing graziers on each year's income is very well brought out by the above table. "The base of the tax", as suggested by Sir Josiah Stamp, "must be a long enough period to give a fair average indication of means—the base upon which a man's household and conditions of life are naturally laid out".¹ A system of the carrying forward of losses is only a weak palliative for the hardship caused by the taxation of fluctuating incomes modulated on a graduated basis. It would be preferable to take as the statutory income the amounts received during the last preceding year in all cases except rents, interest, wages, and income from public employments. By this system income is taxed as it accrues, and it is therefore simple and convenient. The extension of the preceding year basis to schedule E in Great Britain is advocated by the Income Taxpayers' Society as avoiding estimates, supplementary assessments, reliefs, and refunds. The system of estimating income for a future period for income-tax purposes on the average of the three preceding years as followed in Great Britain in the case of profits of trades, manufactures, etc., while for super-tax purposes the last preceding year is taken as the basis of assessment, is in itself somewhat anomalous.² A uniform basis of assessment on the income of the last preceding year is desirable, as it tends to simplicity, and as actual figures corresponding closely in point of time with the amount of profits actually being made are infinitely better than estimates. The Royal Commission on Taxation in Australia has recommended that the basis of liability should be the net taxable income of the twelve months immediately preceding the year of assessment, and the measure of the rate of tax should be the average net taxable income for not more than five years immediately preceding the year of assessment. The reason why the rate of tax should be based on an average and not on the preceding year is to do justice to fluctuating incomes. The Royal Commission of England is not in favour of granting to trades the option of yearly or three-yearly assessment. The Commissioners

¹ *Fundamental Principles of Taxation*, p. 27, Macmillan, 1921.

² No fewer than forty members of Lloyd's went out of business in the "boom" year in order that they might avoid paying the tax on the profits of that year. On the Stock Exchange a number of firms resigned their membership for a similar reason. A system of taxation which drives people out of business and makes collection difficult in bad years, evidently stands in need of reform.

are emphatic in their opinion that no general option should be given to the taxpayer to elect, when the basis is changed, which of the two systems he will be assessed under, and that any remedy provided should apply only in the case of proved hardship.

EVASION

8. The question of evasion has assumed a new importance in most countries since the War. Many countries, such as Great Britain and the United States, have recently imposed stiff penalties against those who are so unscrupulous as to be culpable of fraudulent avoidance of the income tax. The principle is universally held that nobody should be allowed to escape, whether fraudulently or unintentionally, his share of the income tax, provided he comes within the range of income tax. The heavier the burden the sharper should be the punishment on these deliberate cheats, weaker vessels, or anti-social offenders who enrich themselves at the cost of others. The annual defalcations cannot be ascertained with strict accuracy. In Great Britain they have been conjectured to be as much as £100,000,000 annually, but when this figure was put before the Royal Commission on Income Tax in 1920 it was forthwith repudiated as an impossibility. Competent opinion seems to place the deficiency not higher than £10,000,000 a year. The application of Pareto's Law to British Income Tax shows very little deficiency on the whole. In many other countries unfortunately this is not so. In countries where the income tax is of more recent origin, there is no legitimate pride in the conscientiousness with which the inhabitants meet the impost. Income taxpayers are sometimes classified into the following grades: half of them are probably straightforward in their dealings and, of course, suffer from the dishonest practices of their competitors. Of the remaining half, it may be said, one-half give themselves the benefit of the doubt, while the other half do not hesitate to make a deliberate fraud. The "snowball" system of valuing stock is not unknown in the commercial world. A diamond merchant, for example, was convicted of returning no profit whatever in a twelvemonth, on the ground that he has not sold the whole of his stock and is uncertain whether there will be a profit after the sale of the entire stock. The remedy is increased efficiency in detecting these

frauds and evasions. This applies to Britain. In India frauds sometimes take place in various ways, viz. deposits may be placed with the banks in the name of the owner or frequently some other person, so that it escapes income tax. Again accounts may be kept somewhat loosely, and by being in Native States the owner of the property in British India may succeed in evading his full share of taxation. This is, however, not peculiar to India. Not infrequently, it is said, some keep three sets of ledgers, one for the Income Tax Collector, one for Law Courts, and another for private use. Moreover, there is the case of bogus companies. Some time ago the Government of India pointed out that bogus firms and private companies were formed in which the proprietors, partners, and shareholders were the wives and children of the owners of the business concerned, and thus liability to super tax was greatly diminished or totally avoided. This was common in England until legislation minimised it. There is also the case of granting big loans with no interest to the principal shareholders of private companies—a procedure which is in reality a distribution of profits. The Government of India are taking stringent measures to put an end to these abuses. In most industrial countries it is found advantageous to set up an efficient staff of collection and to establish a special investigation branch to deal with evasion and to provide for the production of books and documents.

In Great Britain a foreign trader conducting business in the country may arrange the course of business by invoicing goods to the English branch at an unduly high price, and thus the English profits may be reduced considerably. In such a case it has been provided by Rule 7 of the All Schedules Rules of the Income Tax Act of 1918 that, where a non-resident person not being a British subject or a British Indian Dominion or Colonial firm or company carries on business with a resident person and that, owing to the close connection between the two and to the substantial control exercised by the non-resident person over the resident, the course of business is so arranged that no profits or loss other than the ordinary profits which might be expected to arise from that business, accrue to the resident person, the non-resident person shall be assessed in the name of the resident, as though the latter were his agent. In other words, the relation of buyer and seller may be ignored and the non-resident person treated as though he were

selling direct to the British customers through his branch or agent. Under Rule 12 it is possible to fix the rate of profit on an equitable basis, fixing it at the same rate as the indigenous merchant or a retail dealer in the country can reasonably expect to make. Before the passing of section 21 of the British Finance Act of 1922 it was possible for owners of large estates to evade the payment of super tax and to reduce their liability to death duties by converting themselves into one-man companies.

Pitt in his famous speech of December 1798 introduced the income tax in order "to repress those evasions so disgraceful to the country, so injurious to those who honourably discharge their equal contribution, and, above all, so detrimental to the great object of national advantage which it is intended to promote".¹ Gladstone in his first Budget speech² said, "There are many cases, in trade, in which it is a matter of extreme difficulty to know what return to make, what really is chargeable as profit; and I believe that in not infrequent cases the doubt is solved by the honourable trader against himself, and that he returns his profits greater than they really are. Let it not be supposed that I am going to impute to the trading classes of England generally the conduct which is pursued by some individuals. I am going to state an extreme case. It is an example, not of what has been generally done, but of what can be and has occasionally been done upon the scale I am going to show, and of what, I fear, on a smaller scale is often done. I will mention no names—I will violate no confidence—but I will state what happened in a great town where a new street was to be built. The persons who lived and carried on business in the old street, which was pulled down to make way for the new one, had been charged at a certain amount to the income tax. They had also, of course, made returns at a certain amount under the income tax. When the new street came to be built they claimed compensation for the loss of their business. The amount had to be assessed by a jury. Without wearying the Committee with details I will state the amount of compensation which these persons—in number twenty-eight—claimed; the amount awarded them by the jury, which may be taken as, on the whole, an approximation to the real value; and the amount at which they returned their profits under the income tax. Were I to descend to individual cases it would be almost impossible

¹ Page 4, Hansard, vol. xxxiv. 1798–1800.

² 1853.

adequately to describe the partly ludicrous and partly shameful aspect which they assume. I will therefore deal with the matter generally and say that twenty-eight persons in all claimed the sum of £48,159 as compensation for their profits for a single year. The amount of compensation awarded by the jury was £26,973 or a little more than half what was claimed. But what was the amount at which they had returned their profits for assessment to income tax ? They claimed £48,000 ; they got from the jury nearly £27,000 ; but the return of profits for the assessment to the income tax which they separately made had amounted only to £9000. I deeply regret that the great body of honourable men who have made the name of British commerce famous throughout the earth, less even for its energy than for its truthfulness, should be degraded by association with persons who could perpetuate frauds like these. But at the same time frauds of this kind, and in many other cases, do exist ; they are inseparable from the character of the impost, human nature remaining as it is ; and it is impossible, when you are called upon to consider the question of the readjustment of the tax, wholly to dismiss them from consideration." This would, of course, hardly be possible in England to-day, but it is a lesson to countries with less experience in income-tax procedure and practice. The solution is increased efficiency in administration. Steps have, for example, been taken in India to improve the administration by the creation of a Central Board of Revenue, and not without success.

At the same time, while the income-tax authorities are carrying out with care and management all the acts, it is fair only to say that as the tax is exacting and inquisitorial the tax collector has to avoid as far as possible any invasion on his part and should assist the taxpayer as far as it lies in his power. In some cases it is his duty, for example, to point out cases where the assessee should claim rebate. It also lies with the assessee to recover taxation : a matter often forgotten. The full rate of income tax is deducted from incomes whether liable to income tax or not, and the sufferer is left to recover it if he or she can. It is doubtful whether 50 per cent of those entitled to relief are aware of the fact, and therefore it is desirable that every possible information and assistance should be given by the taxing authorities to enable the public to ascertain their rights and liabilities. Too great emphasis cannot be laid on the importance of obtaining adjust-

ments promptly, as otherwise the taxpayer is exasperated, the machinery of income tax is brought into disrepute, and the tax becomes unpopular. Special attention should be given to the issue of up-to-date and simplified forms. One important method of simplification is to substitute, as indicated in paragraph 7, the last completed year for the current year as the basis of assessment, except in the case of salaries. Efficiency is the pure milk of income-tax administration.

PARETO'S¹ LAW AND EVASION

9. To test the accuracy of income-tax returns the well-known law of Pareto may be applied. Briefly expressed, the law is that if N represents the number of incomes above a certain amount X per annum, and a and A are constants,

$$N = \frac{A}{X^a},$$

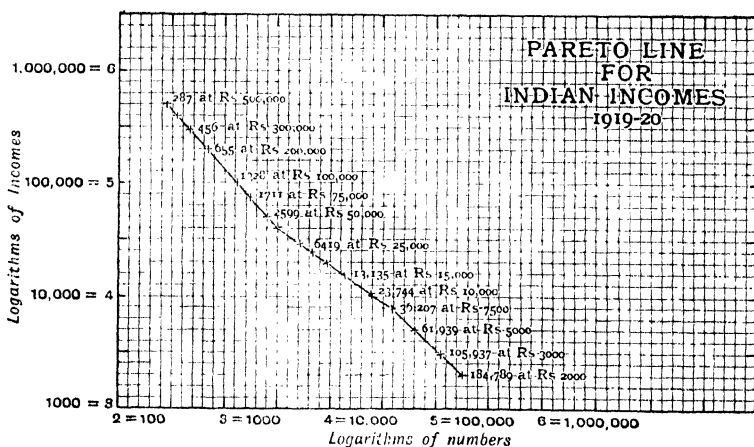
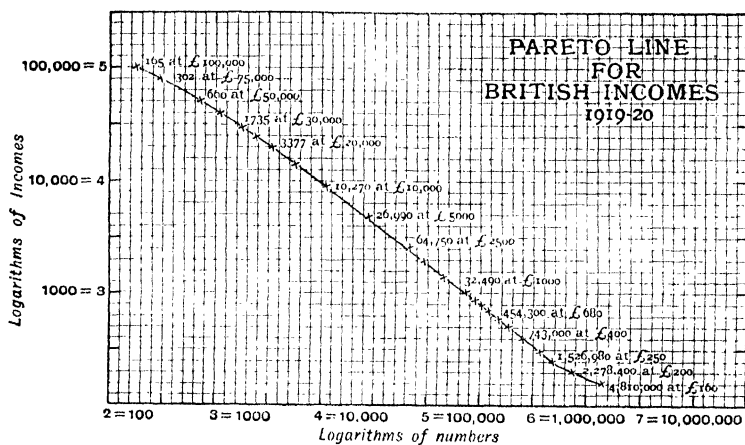
and therefore $\text{Log } N = \text{Log } A - a \text{ Log } X$.

In other words, if the logarithms of the numbers of persons in receipt of incomes above definite amounts are plotted against the logarithms of the amounts of these incomes on a chart the points so obtained would be on a straight line. In practice, however, the line is not absolutely straight, but rather in the form of a reversed and elongated S, as will be seen from the curves for the United Kingdom below. The deviations from the law are not unnatural at the ends of the lines, because as one approaches impossibly high incomes the numbers fall off; and if the law held absolutely throughout it would give one man at the top with an enormous income and an innumerable number at the other end with incomes much below the subsistence level. In short, Pareto's Law expresses in a very satisfactory manner middle-class incomes, and has a tendency also to express all incomes except at the ends. It can be relied upon for finding the number of

¹ For a discussion of the law see *British Incomes and Property* (Stamp), London, King & Son, 1920, chap. viii. p. 332; *Wealth and Taxable Capacity* (Stamp), London, King & Son, 1922, p. 80; *The Economics of Welfare* (Figuou), London, Macmillan, 1920, Part V. chap. ii. p. 693; *Report of the Select Committee on Income Tax* (House of Commons), No. 365, 1906; also the *Quarterly Journal of Economics*, February 1914 ("The British Super Tax and the Distribution of Incomes").

incomes in the middle, but cannot be extended in safety beyond a known range for which statistics are available.

The application of this law to the income-tax statistics of the United Kingdom and British India is of great interest. The two lines below give the Pareto lines as obtained with the statistics



of income tax for the United Kingdom and British India in the year 1919-20. The typical Pareto line is shown in the case of the United Kingdom. In the case of India, however, we find two parallel lines connected by a third. The characteristic tendencies at the ends of the Pareto line are wanting in the case of India. The variation at the lower end might be obtainable if the incomes

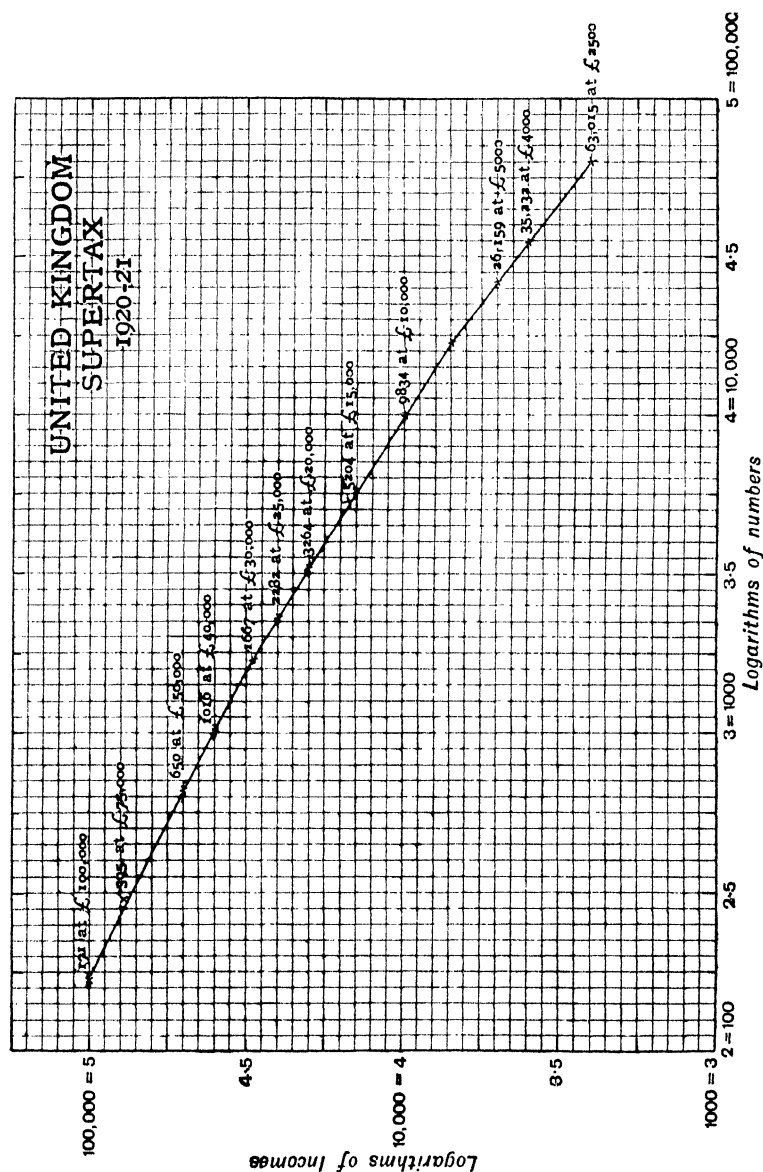
below Rs.2000 per annum could be plotted, but statistics are not available. The incomes below Rs.7500 and above Rs.40,000 lie on lines which are more or less parallel, and those between Rs.7500 and Rs.40,000 form a cross over or connecting link. The existence of two parallel lines connected by a third may give support to the theory that although Pareto's Law applies to earned and also investment incomes, yet the application is not the same in both the cases. In other words, the incomes below Rs.7500 per annum are predominantly earned and those above Rs.40,000 per annum are predominantly derived, while those between the two mark the stages where the one passes into the other. The value of alpha for the parallel lines is about 1.2 as against 1.53 arrived at by Dr. Bowley for the United Kingdom and 1.68 by Dr. Stamp also for the United Kingdom. As agricultural incomes are excluded, nearly 71 per cent of the total incomes of India are not taken into account, and this may have an appreciable effect on the Pareto lines. In short, the absence of agricultural incomes vitiates in every probability the application of Pareto's Law to Indian income-tax statistics. At all events the curves show, *ceteris paribus*, the incompleteness of these statistics.

In all countries super-tax statistics are more accurate than income-tax statistics, because there is less chance for evasion.

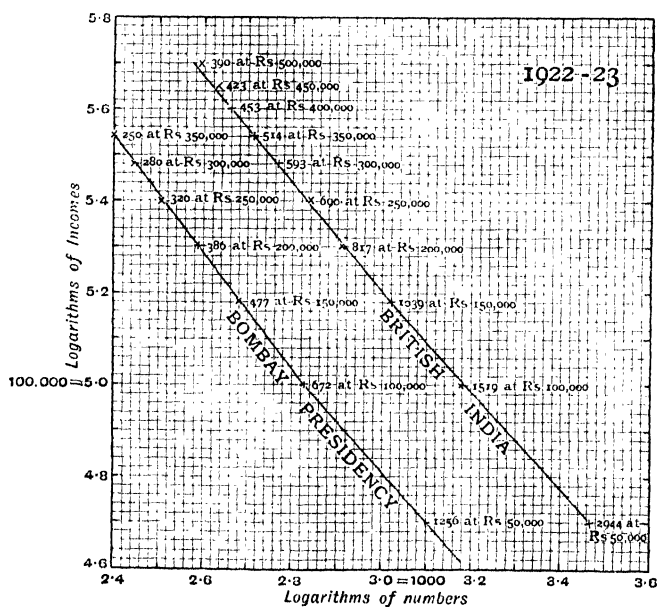
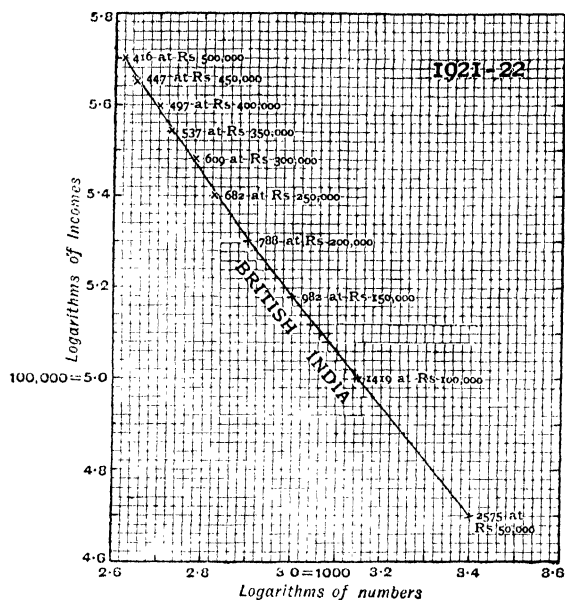
In the United Kingdom the typical Pareto line is noteworthy, but in the case of India the same irregularity is visible, as was noticed in the income-tax statistics. We are irresistibly driven to conclude that although evasion takes place in the United Kingdom it is infinitely less than in the case of India. The statistics of income tax in India are very incomplete, and for many incomes statistics are not available, since income tax is not paid on these incomes.

Evasion is to some degree due to a feeling of distrust of the taxing authorities, which is encouraged by the fact that the revenue authorities collect as much as they can. In fact the higher rates of income tax in some countries have produced a sense of inequity, and the Government authorities have called the game and the rules are "Keeping strictly to the law, you dodge me and I dodge you". It is necessary to ensure, as we have seen, that all permissible allowances are given by the revenue authorities in arriving at the assessments. Taxpayers

are ignorant. On the other hand, the law is complex. A simpli-



fied income-tax law will materially reduce the earnings of lawyers and accountants whose help is at present in constant requisition.



At the same time it cannot be denied that the clamour for a simple income tax is absurd. A tax which reflects difference in ability based on the amount of income, marital condition, family responsibility, and also origin and source of income, is bound to be a highly complicated tax system.¹ Assistance should, as already noted, be given by officials to prevent the possible faults often noticed on the part of taxpayers, and the machinery for the recovery of money due to the taxpayer should always be efficiently brought out. In short, there must be no invasions of the tax collector if there are evasions of the taxpayer. As is well said, a false sense of sport that regards Government as fair game, quite as much as deliberate fraud, has been responsible for evasion.

CONCLUSION

10. The problem of double income taxation has been dealt with in a previous chapter.² It remains to summarise the conclusions to which this analysis has irresistibly led. During the Great War the experience which England gained in the Crimean War was repeated. The income tax proved to be an excellent fiscal reserve to Great Britain as well as to the United States. It enabled these countries to meet war expenditure of almost incredible amounts, when men do not stop to inquire into details of taxation lest they should lose the mass and the substance. France and Imperial Germany, long before 1914, had not realised the importance of this great engine. Many of France's post-War problems are due to the fact that she developed the taxation of income too late. Imperial Germany found indirect taxation wholly inadequate for her requirements, and she was precluded in the War from using direct taxes, the prerogative of the States and not of the Federal Government. India and the Dominions have realised the importance of the taxation of income, Australia having a State income tax in addition to a Federal income tax. Indirect taxes, such as excise duties, cannot be enforced or developed until administrative arrangements have been made, often requiring extra staff and money. With the income tax it is otherwise. The administrative machinery, when once in order,

¹ Cf. Sir Josiah Stamp's evidence before the Royal Commission, paragraph 9581 (11), p. 457, vol. 3, Cmd. 288-3, H.M. Stationery Office, London, 1919.

² Chapter XVII.

does not require corresponding increases when the rate of income tax is increased, and thus the yield can be increased rapidly. This elasticity is a great practical advantage when revenue is suddenly required. The last century witnessed the income tax on trial; the present century has seen the excellence of the income tax as an elastic source of revenue, and the triumph of its principles and methods in the turmoil and stress of war and post-war finance. In Federal constitutions income tax is either (1) wholly Federal or (2) partially Federal and partially State or provincial. In the United States the income tax is Federal. There is, however, in the states of Wisconsin, Massachusetts, New York, Oklahoma, Missouri, Virginia, and Delaware, as we have seen, a Commonwealth or State income tax. In Australia there is a Federal and a State income tax.¹ In the Union of South Africa income tax is levied by the Union Government. In Canada it is imposed by the Dominion Government. In India the tax is central. In France there is (as we have seen) an interesting scheme by which the Central Government collects its own revenues (income taxes), but it also collects additional taxes (*centimes additionels*) on these for departments and communes. This still continues, and is worthy of notice.

¹ Chapter XXI. p. 253.

CHAPTER XXIII

DEATH DUTIES OR INHERITANCE TAXES

1. THE SECOND GREAT SOURCE OF DIRECT TAXATION

“THE fashion of this world passeth away,” wrote the greatest of the Christian apostles, and the truth of this is clearly seen in the change of fashion in regard to taxation at the end of the nineteenth century. States were discovering new sources of revenue, and they were finding that indirect taxes would no longer be so fashionable on account of the discovery of a second great source of direct taxation—death duties. In Great Britain, and especially in the United States, the idea was growing that the collection of a tax on the transfer of property from the dead to the living on systematic lines was a means of obtaining a fairly large and regular amount of revenue with the minimum of inconvenience.¹ The reforms in Great Britain thirty years ago have borne much fruit in this respect: In the United States, especially since the eighties of the last century, this form of taxation has become so popular that to-day in forty-eight out of forty-nine states of the Union there are inheritance taxes in addition to a Federal tax. In the self-governing Dominions of Australia, New Zealand, Canada, and South Africa; in Crown Colonies, such as Ceylon, the Straits Settlements, Hong Kong, the Bahamas, the Barbados, Trinidad and Tobago, Jamaica, the

¹ See (1) *The Inheritance Tax—a Historical and Economic Comparison between the various Countries*, Max West, New York, Columbia University Press (2nd edition, 1908). This includes all the important countries, the Dominions, and the States of the American Union. (2) *Die Besteuerung der Erbschaften in den wichtigeren europäischen Staaten, mit besonderer Rücksicht auf die schweizerische Finanzreform*, E. Grossman, Berne (Max Diechsel), 1917. (3) *Taxation of Capital*, Soward and Willan, London, Waterlow & Sons, Ltd., 1919. (Contains on pp. 75-81, bibliography of English works, also many footnotes and useful references to Dominion and foreign laws, etc.)

Leeward Islands, British Guiana, the Falkland Islands, Fiji and Sierra Leone; in other countries such as France, Germany, Holland, Switzerland, Belgium, Italy, Norway, Sweden, Chile, and Japan there are death duties. India alone of the chief countries of the world does not possess this means of revenue, although it is probable that in the not distant future such taxes will be imposed, as the needs of Provincial Governments for nation building activities, especially education, are so great.

While the development of death duties or inheritance taxes in recent years is remarkable, it should be remembered that taxation of this kind is in reality very old. Augustus levied a 5 per cent tax, the *vicesima hereditatum et legatorum*, for the payment of the army on those whom he could not reach by the *tributum* or the ordinary property tax, the property tax being leviable only in the provinces. In feudal times estates reverted to the King when there were no rightful heirs, and at the end of the eighteenth century there was a legacy duty in Holland. North introduced, doubtless from Holland, a stamp duty upon any receipt for any legacy or share or residue of the personal property of a deceased person, a duty increased by Pitt in 1789. In 1796 the property itself was charged, and a tax was imposed on collateral successions at different rates. Successions to land, however, were not taxed till fifty-seven years later. As early as 1826 there was an inheritance tax in Pennsylvania.

2. GENERAL PRINCIPLES

To tax progressively real and personal property on the death of its owner or owners,¹ and also on its acquisition by beneficiaries, exempting to some degree immediate dependants, and increasing the rates in collateral inheritances or bequests to strangers, is sound in theory and in practice. It forms part of any well-arranged scheme of public finance. In Adam Smith's words it is "perfectly clear and certain", and the time of payment "sufficiently convenient". It is also productive. The tax is usually graduated in three ways. The amount may vary with the value of the estate to be transferred. This is so in the case of estate duty, which in Great Britain varies from 1 to as much as 40 per cent. The Federal tax in the United States is imposed on this

¹ See paragraph 8 on the taxation of the joint Hindu family.

basis. The tax may also vary according to the relationship of the beneficiaries to the deceased, the highest rate of tax falling on distant heirs. Legacy and succession duties in Great Britain and elsewhere vary according to consanguinity. Thus in Great Britain these vary from 1 to 10 per cent, and in the Union of South Africa from 2 to 10 per cent. Thirdly the tax may also, as in France, vary with the amount inherited by each individual heir. This discriminates against leaving large sums to one or two persons only, and tends to prevent the accumulation of property among a few people. It is therefore eminently reasonable, and it is probably on this account that this third form of taxing is popular with the Commonwealth Governments of the United States. Lord Randolph Churchill, had he not impetuously sent in his resignation in 1886 as Chancellor of the Exchequer when he regarded himself as indispensable, would have imposed a graduated duty according to the total benefit received by each individual and not according to the value of the whole estate before distribution.¹

The State protects the property of the individual, and it is not unfair that it should come in at the death of the owner of the property and take a share in the form of taxation before it is passed on to the beneficiaries. As Gladstone well put it, "The carrying property in perfect security over the great barrier which death places between man and man is perhaps the very highest achievement, the most signal proof of the power of civilised institutions . . . and an instance so capital of the great benefit conferred by law and civil institutions upon mankind, and of the immense enlargement that comes to natural liberty through the medium of the law, that I conceive nothing more rational than that, if taxes are to be raised at all, the State shall be at liberty to step in and take from him who is thenceforward to enjoy the whole in security that portion which may be *bona fide* necessary for the public purpose".² The curtailment of the right of bequest in this respect on the part of the State is just. The argument that inheritance taxes directly prevent some of the most glaring inequalities of inherited wealth is a matter for the politician rather

¹ Churchill also proposed to treat real and personal property alike, and to abandon the various rates according to consanguinity. See *Lord Randolph Churchill*, by Winston S. Churchill, vol. ii. chap. xv.

² Hansard, vol. cxxvii. p. 267, "Speech on Succession Duties", 12th May 1853.

than for the financier. An argument is sometimes used with far less frequency now than thirty or forty years ago, that death duties fall on capital and discourage production. It has also been said that these taxes in reality reduce saving and retard progress. What, however, are the facts, and what is the experience of the last decade ?

3. THE TAXATION OF CAPITAL

We have travelled a long way from Ricardo, who condemned the taxation of capital. Marshall, too, when he wrote that "the old objection to taxes on inheritances that they are paid out of capital seems to me to have great force still"¹, had not realised the effects of war finance on income tax as compared with death duties or perhaps of the prodigious pace at which capital now accumulates in industrial countries. Financial experience shows that in a modern industrial country the amount of capital taken in the form of inheritance taxation, which might otherwise go to maintain the productivity of labour, is not of importance as against the total capital in use or the annual increase in capital. The great Cambridge economist, Henry Sidgwick, whose "natural bent", in the words of Bryce, "was to distrust all that was obvious and to discover flaws in every accepted doctrine", rightly held that the drawback to death duties "is not at all likely to be equal in proportion to the similar effect that would be produced by extra taxes on income ; in fact, the limits of taxation on inheritances will be practically determined for the financier rather by the danger of evasion through donations *inter vivos* than by the danger of checking industry and thrift".² Death duties have indeed certain advantages over income tax. The owner enjoys his wealth during his lifetime, and he can also have the pride of leaving large sums at death. Human nature being what it is, family love and pride being so strong, and the motive for saving and accumulation thus so powerful, people do not save less on the whole because a lump sum will have to be paid at death. Governments have taken steps to prevent all possible evasion, as, for example, in Great Britain, where gifts *inter vivos* are subject to the tax if made within three years of death. The proceeds of the tax often connote a mere transfer of capital, as when the State pays off debt with the proceeds of the tax. Expenditure on social

¹ C. 9528, p. 123.

² *Principles*, Book III. chapter viii. section 11.

services may result in increasing the country's productivity by raising the standard of efficiency, especially if, as in some countries, there is undoubtedly under-consumption among the working classes. A net gain and all-round prosperity thus results in the long run. But if by high taxation of inheritances the development of incomes were checked—it is a big “if”—without a compensating increase in other directions, there may be a reduced demand for goods and services with an ultimate effect on employment. In short, as capital and labour are mutually dependent on one another, anything that checks the supply of one may react adversely on the other. This view, however, loses sight of the vastness of the savable fund, which is not really affected by the withdrawal of part of its volume in the form of inheritance taxes. Experience has shown that the gain does outweigh the loss, and the net effect, after taking into consideration all factors, is not against this form of taxation. Sir Josiah Stamp summarises well the position when he says “people greatly exaggerate this matter, because they forget that the money must be raised somehow; and from the gross effect of the death duties on capital, they fail to take off the effect that other equivalent taxes would also have upon saving. (1) As a broad conclusion, therefore, apart from other economic effects of death duties, even current expenditure of the proceeds is likely to add to the nation's power of accumulation more than the actual capital it takes from individuals. (2) Immediate effect on realised savings: (a) In so far as Government expenditure is on permanent works or reduction of debt there is only a transfer of capital; (b) if it is not so spent, savings may be ‘wasted’, but if the money had been raised by other taxes, potential saving might have been ‘wasted’ to just the same extent, and no special disadvantage attaches to death duties. (3) Ultimate effect on stimulus to saving: Owing to powerful countervailing considerations the net effect is only slightly against the death duties as compared with other taxes.”¹

4. RIGNANO'S SCHEME OF INHERITANCE TAXATION

Professor Rignano² has suggested a special form of inheritance

¹ *The Principles of Taxation*, p. 155 (Macmillan), London, 1921.

² “Una riforma socialista del diritto successorio”, *Socialismo in accordo colla dottrina economica liberale*.

tax which would avoid inequalities of income without discouraging production. Briefly, his scheme is to make the inheritance tax progressive in time, *i.e.* the tax would increase with the frequency which the property changed hands through succession. He suggests that the whole of any wealth accumulated should lapse after passing through a certain number of heirs. The older the fortune, the heavier the inheritance tax. The rates of tax and the length of time before the State absorbs such accumulated wealth would vary on account of the financial stress and other economic conditions of each country. Suppose A leaves to B self-accumulated property, and the tax on B's inheriting the property may be 25 per cent of the total, and B dies leaving C the property which he inherited from A, and also the property which he acquired through his own exertion. In the case of C the tax would be 50 per cent of A's property plus 25 per cent of B's. When C dies leaving D his property the State would take 75 per cent of A's property plus 50 per cent of B's property and 25 per cent of C's. When D dies leaving E his property the State would take the whole of A's property plus three-fourths of B's, half of C's, and one-fourth of D's. The advantage of the tax is that it falls more lightly on newly acquired wealth, and it would, in Professor Rignano's opinion, from the fact that inherited wealth would be insufficient to provide for one's successors, be an incentive to the actual accumulation of wealth. The obvious objection to the Rignano scheme is the difficulty of administration. The rights of heirs to dispose of inherited wealth would require to be strictly curtailed in order to prevent evasion, and this in itself would be a complex matter. The danger of evasion likely to occur especially when high duties were in force would not be inconsiderable, and this evasion, of course, varies extraordinarily in different countries, being less for example in Great Britain than in most countries.

5. DEATH DUTIES OR INHERITANCE TAXES IN FEDERAL CONSTITUTIONS

In Federal constitutions the imposition of succession taxes or death duties raises the question whether these taxes should be levied by the Federal or Central Government, by the State or Provincial Governments, or by both. In Switzerland this taxation

is imposed by the cantons and the taxation varies considerably from canton to canton. In the United States the taxation has been, with few exceptions, a matter mainly for the State or Commonwealth Governments. The Federal Government on rare occasions, as in 1862, also imposed a Federal tax. At present a Federal tax in the form of an estate duty is in force. In Canada the taxation is provincial. In Australia, estate, legacy, and succession duties are levied by the Federal as well as by the State Governments. In the Union of South Africa, Cape Colony and Natal had this form of taxation before the Union Government constituted under the South Africa Act, 1909, came into being, but this legislation has been superseded by the Union Act.¹ Taxes on succession or on acquisition by survivorship in a joint family are in accordance with the rules under the Government of India Act, 1919,² reserved for Provincial Governments.

Seligman³ supports the view that succession duties in the United States should be a Commonwealth or State tax and not a Federal tax. "One of the chief steps in the reform of American finance has been the growth of the inheritance tax as a Commonwealth tax and its development, together with the corporation tax, as a main, or in some cases almost an exclusive source of Commonwealth revenue, thus permitting the other sources of revenue to be relegated to the local divisions. The imposition of a Federal inheritance tax, while perfectly justifiable in itself, would tend to check this salutary development. It would supply the Commonwealths with a reason for not adopting the inheritance tax as a source of State revenue, and it would render far more difficult a rounding out and logical arrangement of the entire tax system. It may be said that just as an income tax is far better as a national than as a State tax, because so many complicated questions of domicile and double taxation are avoided, so in the same way, and largely for the same reasons, a Federal inheritance tax is preferable to a State inheritance tax. But even if this be true, the advantage is dearly purchased at the cost of an entire reversal in the march of progress towards a consistent and logical revenue system for the entire country. It may be

¹ 9 Edw. VII. c. 9.

² Rules under Section 80 (A), (3) (a), Schedule I.

³ *Essays in Taxation*, chap. v., Macmillan, 1921, 9th edition. There is a considerable bibliography in the footnotes.

possible to find some method of filling the gap created in the Commonwealth tax system. But it seems a pity, to say the least, to check a promising movement when the difficulty of making any changes at all are so great as in the local tax systems of the United States at present.”¹ Seligman is probably biased in favour of the provincialisation of the tax because of the unsatisfactory nature of the property tax as a main source of revenue to the Commonwealth or State Governments. He realises at the same time the dangers in such taxation when there is no uniformity in the rates of these progressive taxes between state and state. The absence of inter-State agreements as to rates and of the provision of similar treatment where property in different states is assessed for the tax is clear, and he speaks indeed of a Federal inheritance tax being “perfectly justifiable in itself”. Another well-known American writer² holds that the tax should be provincial; “until the states are forced to abandon all control over family relations, and to surrender to the Federal Government the entire field of legislation relating to property, and the inheritance thereof, it will be illogical and harmful for the Federal Government to tax inheritance. . . . The question is one of deep political import.” Since this was written, the Federal Government has, as we have seen, imposed a Federal tax in addition to that of the states. The relegation of succession duties to Provincial Governments in India was probably on the analogy of Canada and other Dominions. Moreover stamp duties are a provincial subject for taxation. But in India the question mainly resolves itself into this—as the introduction of such taxation is not yet a settled fact, would the administration of the tax be easier and more efficient as a central tax or as a provincial tax? As a central tax the dangers of different rates of progressive taxation in different provinces would be avoided. On the analogy, therefore, of the income tax, this might possibly be assigned to the Central Government. On the other hand, as a considerable portion of the duties will be from land, and as land revenue is already a provincial subject, should not the tax remain as a provincial matter? Provincial Governments would have to pay less as provincial contributions to the Central Government if the

¹ *The Income Tax*, 2nd edition, Macmillan & Co., Ltd., New York, 1914.

² Plehn, *Introduction to Public Finance* (3rd edition), Part II. chap. viii. p. 310 (Macmillans, 1916).

tax were administered centrally as is the income tax. The more widespread are inheritance taxes, the less is there an opportunity for a convenient change of residence. The peculiar circumstances, however, of each country have to be considered carefully with a view to the efficient collection of this class of direct taxes, and certainly in India the co-operation of the Central and Provincial Governments would be in a matter like this essential.

6. DEATH DUTIES IN GREAT BRITAIN

Death duties in Great Britain¹ are derived from two main sources, (a) estate duty which is a transfer on property, the State taking a percentage of the net value on the death of the owner; and (b) legacy duty and succession duty, which may be regarded as an acquisition duty payable by a beneficiary or beneficiaries on acquiring property. These duties are a growing source of direct taxation and can also be budgeted for with tolerable accuracy, even allowing for "windfalls" that may accrue from very large estates being subject to duty in any year.

Year ended 31st March.	Budget Estimate (£ millions).	Net Receipt (£ millions).
1913 . . .	25	25
1914 . . .	27	27
1918 . . .	29	32
1919 . . .	32	31
1920 . . .	35	43
1921 . . .	45	47
1922 . . .	48	53

Death duties were in 1921-22 about 6 per cent of the total tax revenue or 5 per cent of the total revenue receipts.² By far the greater portion is derived from the estate duty. Thus for the year ended 31st March 1922 the net proceeds were approximately £53,000,000, and were made up as follows: Estate duty £45,000,000 or 84·7 per cent of the total; legacy duty, £6,000,000 or 11·3 per cent; succession duty, £1,200,000 or 2·3 per cent;

¹ *The Death Duties*, R. Dymond (London, Solicitors' Law Society, Ltd., 3rd edition, 1920). (A systematic work.) *Practical Guide to the Death Duties and to the Preparation of Death Duty Accounts*, C. Beatty (London, Effingham Wilson). (A short manual.)

The annual Reports of the Commissioners of H.M.'s Inland Revenue contain the statistics showing the analysis of realty, personality, etc.

² *Vide* Table XII. App.

and miscellaneous receipts, £800,000 or 1·7 per cent. Death duties yielded £58 millions in 1923-24 as compared with £57 millions in the previous year.

The estate duty is an *ad valorem* progressive tax levied on the value of all immovable or movable, settled or unsettled property in Great Britain which passes upon the death of any person. It dates from the Finance Act, 1894,¹ and the father of the tax was Sir William Harcourt, Chancellor of the Exchequer in Lord Rosebery's Government. Harcourt belonged, in the words of his biographer, "to the old tradition of statesmanship which regarded a rigid public economy as the first essential of good government. He believed that an extravagant and wasteful habit of expenditure corrupted the public service, and had subtle reactions on policy, especially where the demands of the war departments were concerned. But it was not the spending of the national resources that furnished his chief interest in the subject. He had long been conscious of the anomalies of taxation, especially in regard to the land. A member of a landed family himself, he had early broken with the views of his class in regard to the special privileges with which a legislature, then chiefly controlled by the landed interest, had invested real estate, and the political disagreement with his brother at Nuneham had turned mainly upon this theme."² The introduction of Harcourt's proposals raised in some quarters considerable criticism and even opposition. The Conservative viewpoint is well expressed in a letter to the Chancellor of the Exchequer from Her Majesty, Queen Victoria, who wrote from Balmoral Castle on 5th June 1894 as follows :

The Queen is much concerned about the provisions made in the Budget regarding the death duties, which, in her opinion, cannot fail to cripple all landowners. Many properties are now only kept

¹ Exactly 200 years previously (*i.e.* 1694) a tax in the form of a stamp duty was imposed upon probate or letters of administration for any estate above the value of £20. This came to be known as probate duty. It was increased to 10s. in 1698, and North, in 1779, introduced three scales with reference to the value of the property. This reform was modified to meet the financial exigencies of the State from time to time till 1889, when the duty was fixed at 3 per cent *ad valorem*. These duties did not, of course, include real or settled estate. For 200 years, therefore, real property escaped this form of death duty.

² *Life of Sir William Harcourt*, A. G. Gardiner, vol. ii. p. 281 (London, Constable, 1922).

afloat at considerable loss to the proprietors, who, if the Budget becomes law, may be driven to still further curtail their expenditure. This must inevitably affect the poorer classes, especially the agricultural community, numbers of whom will be thrown out of work altogether. Then again country-seats will be unoccupied and charities throughout the country be denuded of support. Where, again, will be the inducement to owners of property to effect improvements, when by so doing they know they are only encumbering their successors—possibly their widows, who, the Queen fears, are also placed in a worse position than before by the proposed death duties. This leads the Queen to remark that she has always deplored the action of the probate laws which subjects widows and nearest of kin, at the time of deep sorrow, to an immediate minute examination and valuation by some strangers of their private possessions, which she thinks is painful and cruel. Most earnestly does the Queen urge and hope that Sir William Harcourt may be able to modify these proposals, which she owns she thinks dangerous.

To this Sir William Harcourt as Chancellor of the Exchequer wrote to Queen Victoria on 9th June 1894 as follows :

Sir William Harcourt presents his humble duty to Your Majesty, and begs leave to report that in the last few days solid progress has been made with the clauses of the Budget Bill in Committee.

Sir William desires to assure the Queen that the outcry which has been made by the landed interest on the subject of extraordinary pressure upon them in the Budget is grossly exaggerated if not entirely unfounded. Lord Salisbury's statement that it will absorb four years' income is entirely contrary to the fact. In the case of a man with £100,000 the additional taxation will be 1 per cent, and in that of a man with a million, 4 per cent, and in the case of the last it might amount to two years' income payable in eight years. The truth is that the landowners have been so long accustomed to exemption from their fair share of the taxation borne by the other classes of the community that they resent as a great injustice that they should be treated on an equal footing.

It is no doubt a great misfortune that owing to the immense expenditure upon armaments it should be necessary to raise an additional sum of 4 millions by taxation, but that can only be done by imposing the burthen equally upon all classes, with a regard to the ability of the several parties to bear it.

Sir William believes that the great support which the Budget has received in the House of Commons, and still more outside, far beyond the Party majority which the Government can command, is due to a conviction that it is an honest attempt to distribute the burthen fairly and justly amongst all classes of the community.

Of the sum to be raised not one-fourth part will be asked of the landed interest; the rest will fall on the personal property; and yet it is those who will contribute least who complain most.

It is true the land is now in a distressed condition, but it will only pay in proportion to what it received. Other industries are also depressed, but they do not make that a pretext for refusing to pay their share in the public burthens necessary for the defence of the country.

It is a sense of the justice of our demand that gave the Government a majority of over 100 in the division on the question of graduation.

It is quite impossible to raise large sums of money without inconveniencing some one, but no class—and least of all those who are the loudest in their demands for augmented expenditure—ought to refuse to bear their part in the necessary sacrifice.

Sir William is extremely anxious to remove any particular hardships which may arise in the case of the land, and has already opened communications privately with the Opposition to see if it is possible, consistently with the necessities of the public service, to meet their views.

Immovable property in Great Britain is liable to estate duty but not immovable property abroad. By immovable property is meant lands and houses and all interests therein, including leasehold interests. Movable property in Great Britain is also liable to estate duty, and this includes goods, furniture, stocks, shares, and securities. Movable property outside Great Britain is chargeable only when the deceased was the owner and domiciled in Great Britain, or when he had only a life interest, and at his death the movable property became a British trust or vested in a British trustee. Gifts made *inter vivos*, unless made more than three years before death, and gifts made for public or charitable purposes, unless made more than twelve months before death, are liable to estate duty. So are moneys receivable under insurance policies on the life of the deceased, effected and kept by him wholly or partially for the benefit of a donee. Marriage gifts, however, gifts proved to be part of one's normal expenditure, and gifts not exceeding £100 in value in the case of any donee, are excluded. The net principal value of the estate is arrived at by taking the total of the principal values of all the items of property, less deductions for reasonable funeral expenses and subject to certain reductions for debts and incumbrances of the deceased. The principal value of the property is the price which the Commis-

sioners of Inland Revenue believe the property to be worth if sold in the open market at the time of the death of the deceased. Small estates up to £300 and £500 pay fixed duties of 30s. and 50s. respectively and are exempt from all other death duties. Interest at 4 per cent per annum is payable on personalty from the date of the death up to the delivery of the affidavit or accounts. On real property the duty may be paid by eight yearly or sixteen half-yearly instalments, and that on certain annuities in four yearly instalments. Interest is charged on all unpaid portions of duty after death at the rate of four per cent per annum. Exemptions from estate duty include (1) estates of a net principal value not exceeding £100; (2) the property of common seamen, mariners, soldiers, or airmen who are killed or die in His Majesty's Service; and (3) certain articles which are ascertained to be of "national, scientific, historic, or artistic interest". In order to avoid the double taxation of movable property in a British Dominion, movable property pays only so much duty as is equal to the larger of the two taxes. The amount of duty payable in the Dominions is thus deducted from the amount of estate duty due in Great Britain.

The rates of estate duty are set out in the following table. The progressive nature of the duties is obvious, especially on the higher incomes. Thus on £1,000,000 30 per cent estate duty is payable. A further sum, as we shall see, is payable for legacy duty varying from 1 to 10 per cent. If the assumption be made that this is only $3\frac{1}{3}$ per cent, one-third of the value of the estate or £333,333 would be paid as death duties.

Where the Net Principal Value of the Estate exceeds	Percentage Rate of Duty after 31st July 1919.	Where the Net Principal Value of the Estate exceeds	Percentage Rate of Duty after 31st July 1919.
£100 . . .	£1	£150,000 . . .	£17
500 . . .	2	175,000 . . .	18
1,000 . . .	3	200,000 . . .	19
5,000 . . .	4	225,000 . . .	20
10,000 . . .	5	250,000 . . .	21
15,000 . . .	6	300,000 . . .	22
20,000 . . .	7	350,000 . . .	23
25,000 . . .	8	400,000 . . .	24
30,000 . . .	9	450,000 . . .	25
40,000 . . .	10	500,000 . . .	26
50,000 . . .	11	600,000 . . .	27
60,000 . . .	12	800,000 . . .	28
70,000 . . .	13	1,000,000 . . .	30
90,000 . . .	14	1,250,000 . . .	32
110,000 . . .	15	1,500,000 . . .	35
130,000 . . .	16	2,000,000 . . .	40

Legacy and succession duties are complementary owing to their history. The legacy duty is levied on movable property devolving under the will or intestacy of a person domiciled in Great Britain. The movable property wherever situate is liable to duty if the deceased owner was domiciled in Great Britain. If the testator or intestate was not domiciled in Great Britain the property is not liable to legacy duty. All settled movable property, wherever situated, is liable to succession duty if the forum of administration was in Great Britain. But if it was the subject of a non-British trust it is not liable to duty. Immovable property outside Great Britain is not liable to duty under any circumstances. The rates of legacy duty and succession duty are as follows: 1 per cent in the case of a husband, wife, child, or lineal descendant of child, father or mother, or any lineal ancestor; 5 per cent in the case of brother or sister, lineal descendant of brother or sister; and 10 per cent in the case of any other person, including any related only by natural ties. The duties are payable when the beneficiaries become entitled to the benefit, but in certain circumstances both duties may be paid by instalments, extending in the case of real property to a maximum period of 8 years. The legacy duty dates from 1780, and in 1796 an Act was passed "in respect of the acquisition by collaterals and strangers of property through the testacy or intestacy of its deceased owner". The Act of 1796 is in the nature of a tax on beneficiaries, and is still on the statute book. In 1853 a succession duty, also a tax upon beneficiaries, was imposed upon real property and also on settled movable property not liable to legacy duty. No legacy duty is chargeable when the gross value of the personal estate is under £100; and no succession duty is chargeable when the principal value of all the succession is under £100. No duty of either sort is charged in respect of objects not yielding any income. Duty, however, becomes payable if and when the same are disposed of or pass to any one who has a power of sale or disposition. National, scientific, historic, or artistic objects are not taxed except when sold, and then only in connection with the last death on which they passed. Exemption is given to the National Gallery, British Museum, or other similar national institution, or to any University, County Council, or Municipal Corporation in Great Britain, or to the National Art Collections Fund. There are certain exemptions and reliefs in regard to

legacy and succession duties. Neither legacy nor succession duty is chargeable on benefits where the net value of the property passing in respect of which estate duty is payable does not exceed £1000. Exemptions are allowed when the value does not exceed £15,000 and when property passes to a lineal ancestor or descendant or an individual chargeable at 1 per cent rate of duty. Where the beneficiary is the widow or child under the age of 21, and if the value of the benefit passing does not exceed £2000, no duty is leviable.

7. THE DOMINIONS

In the self-governing Dominions, death duties or inheritance taxes are on the statute book. In Canada the legislation is provincial, as, for example, the Acts in British Columbia, New Brunswick, Nova Scotia, Ontario, and Quebec.¹ There is a family likeness among the Acts, and the effect of the United States on Canadian legislation is evident. In Ontario² and Quebec³ the tax is, as in the United States, graduated according to the value of the estate and according to relationship. In most of the provinces exemptions are given, and the tax is greater on collaterals than on lineal descendants or ascendants.

In Australia the Commonwealth estate duty which came into force in 1914 is similar to the British estate duty in that the tax is levied upon the total value of the estate. In the States of the Australian Commonwealth, except South Australia, this is also the case. The term "succession duty", however, does not mean the same as a succession duty levied upon the interest of each beneficiary in all the States. Thus in Queensland there is an estate duty on the whole estate, and an additional tax (graduated according to the total value of the estate) is levied upon the beneficiaries. This latter tax is called a succession duty, although it is determined by the value of the whole estate. Where the total value of the estate passing to wife or lineal issue is below £500, no duty is charged. If it exceeds £500 but does not exceed £2500, one-half of the prescribed rate is charged. If it exceeds £2500 but does not exceed £5000, two-thirds of the prescribed rate is

¹ Prentice-Hall, *Inheritance Tax Service*, Prentice-Hall, incorporated 70, 5th Avenue, New York. (A complete loose-leaf text of inheritance taxation in United States (Federal and Commonwealth States) and of Canada, kept up-to-date by periodical circulars.)

² Succession Duties Act, 1907.

³ Succession Duties Act, 1906.

charged, and where the successor is not a stranger in blood but is other than the wife or husband or lineal issue, the duty charged is the prescribed rate plus one-half, but not more than 15 per cent. Where the successor is a stranger in blood, the duty charged is double the prescribed rates, but does not exceed 20 per cent. In Queensland, in short, there are two estate duties in reality, the so-called succession duty being 1 per cent more than the probate duty or estate duty proper. In South Australia, death duties, unlike those of other States, are in the form of a succession duty similar to that levied in Great Britain. Real property in South Australia and personal property, wherever situated, are dutiable if the deceased person was domiciled in South Australia. Duty payable outside the State on any property not situated in South Australia may be deducted from the duty payable thereon in South Australia. The high rates of death duties in Queensland and South Australia may be seen from the following table :

£50,000 VALUE OF ESTATE

Highest Rates.	State.	Commonwealth.	Per cent to Total Value of Estate.
New South Wales . .	5,000	4,320	19
Victoria	5,000	4,320	19
Queensland	9,833	3,535	27
South Australia . .	10,000	3,440	27
West Australia . .	5,000	4,320	19
Tasmania	5,000	4,320	19

The highest duties payable are 33 per cent in Queensland, 32 per cent in South Australia and New South Wales, and 24 per cent in Victoria and Tasmania. The lowest is about 2 or 3 per cent. In New South Wales duty is levied on real or personal property in the State. Similarly in Victoria, West Australia, and Tasmania. In Queensland probate duty is charged in respect of probate or letters of administration in respect of the Queensland estate of the deceased person, and is payable only on the personal estate which comes into the hands of the executor or administrator. Succession duty of a special nature is also levied according to the aggregate successions, with rebates on the shares of closer relations. In South Australia, death duty, unlike that of other States, takes the form of a true succession duty, as already noted.

In New Zealand death duties are levied in accordance with the Act of 1921.¹ The estate duty ranges from 1 per cent on estates not exceeding £2000 in value to as high as 20 per cent on estates of more than £100,000. The succession duty is also payable by the beneficiaries according to relationship. An exemption from duty is made in favour of charitable trusts, and special provision is made both in estate duty and in succession duty for widows and small estates. Thus if the final estate is not worth more than £10,000, any interest acquired by the wife up to £5000 is exempted from duty, but the rate of duty on the whole estate must be determined before the deduction is made. An exemption of £5000 is also allowed in the case of wife and lineal descendants or lineal ancestors of a soldier who has met his death on account of the late War. The succession duties vary from nil to 20 per cent. An additional 10 per cent of the excess over £1000 is levied in respect of moneys payable to persons domiciled out of New Zealand, and where the beneficiary is not the husband or wife of the deceased or a relative of the deceased within the third degree of consanguinity. As compared with the rates in the Union of South Africa, the New Zealand rates are high.

In Cape Colony² and Natal³ before the Union was formed, succession duties were leviable. There is also the Union Act,⁴ which provides for both the estate and succession duties on British lines. An estate duty on the estate of every person dying on or after the 1st July 1922 is charged at the rate of half per cent on estates up to £2000, and from £2000 to £3000 1 per cent, and on an ascending scale up to 17 per cent on £1,000,000 and over. The rate of duty upon the dutiable amount of succession is 2 per cent where the successor is a direct descendant or ascendant of the predecessor, 4 per cent where the successor is the brother or sister of the predecessor, 6 per cent where the successor is the descendant of the brother or sister of the predecessor, and 10 per cent where the successor is otherwise related to the predecessor or is a stranger in blood or is an institution. Provision is made for the valuation of the property when the succession consists of limited interests therein, and for the refund of a proportionate

¹ No. 21 of 1921.

² Succession Duties Act, 1864, and Amending Acts, 1895 and 1908.

³ Succession Duties Act, 1905, and Amending Act, 1905.

⁴ Death Duties Act, 1922, 29 of 1922.

duty paid should the succession lapse and the interest pass to another. A succession accruing from any predecessor to his surviving spouse, and any succession accruing to any public institution of a charitable, educational, or ecclesiastical nature, or any succession accruing to any provincial administration or municipality or any other local authority are exempt from succession duty. The South African Act applies to the whole of the Union and replaces the provincial laws formerly in force.

8. DEATH DUTIES IN INDIA

The Moghul emperors asserted their rights to inherit the estates of their official nobility and sometimes of their wealthier merchants. Bernier has preserved a letter from Aurangzeb to his father, the Emperor Shahjehan, a part of which reads as follows: "We have been accustomed, as soon as an Omrah (noble) or a rich merchant has ceased to breathe, nay, sometimes before the vital spark has fled, to place seals on his coffers, to imprison and beat the servants or officers of his household until they made a full disclosure of the whole property, even of the most inconsiderable jewel. This practice is advantageous, no doubt; but can we deny its injustice and cruelty?" Aurangzeb, however, did not give up the practice during his reign. The yield from this source was immense—amounting to 19 karors (crores) of rupees¹ on the death of Asaf Khan in 1641. In regard to officials, this confiscation may be said to have been part of their contract of service, and it is only fair that the State should take what they had accumulated by their rapacity. In regard to merchants, however, this system must have handicapped trade and industry considerably.²

In India at present there are no estate or succession duties. There are, however, certain small fees ranging from 2 to 3 per cent of the value of the property, collected under the Court Fees Act of 1870, when probate and letters of administration are granted to an executor or administrator. Where there is no will, it is unnecessary to take out letters of administration except in one instance. Where there is a will, it is necessary to take out probate or letters of administration as the case may be, before

¹ This is probably an exaggeration, but it shows how productive the windfall was.

² Quoted by Moreland in *Akbar to Aurangzeb*, London, Macmillan, 1923.

the will can take effect.¹ Moreover, Indians, especially Hindus, generally do not make wills. The necessity of obtaining revenue from estate and succession duties is obvious to-day when Provincial Governments are faced with the duty of introducing free and compulsory primary education, and also the duty of performing other social services which will increase the productivity of the major portion of the population of the poorer classes. Up to the present time the financial aspect has scarcely, if ever, been raised, and it is only since the War that this question has come into prominence.

The question may be considered from two points of view : (1) The making of all successions liable to taxation. In regard to this, the difficulty of the joint Hindu family system, where there is no inheritance, joint family property being acquired by survivorship and not by succession, will have to be examined. (2) The imposition of an estate duty on the property as a whole at the time when it passes from the dead to the living. All families would be liable to this duty, including (a) non-joint Hindu families, and (b) joint Hindu families, on the share of the deceased ancestor or coparcener, including that of his direct descendants.

¹ The law on the subject at the present time is briefly as follows : The Indian Succession Act of 1865 provides that, in the case of Parsees and Christians, probate and letters of administration have to be taken out when a claim has to be established in a court of law. Under the Hindu Wills Act of 1870, as amended by Section 154 of the Probate and Administration Act of 1881, Hindus, Sikhs, Buddhists, and Jains who, residing in Bengal and in the towns of Madras and Bombay, desire to establish a claim as executor or legatee in a court of law, have to take probate or letters of administration in respect of wills and codicils made in these places. If wills and codicils are made outside those areas, and if they refer to immovable property within those areas, probate and letters of administration have also to be taken. If claims have not to be established in a court of law, the taking of probate and letters of administration is optional. The Succession Certificate Act of 1889 applies to all outside the presidency towns of whatever community when the deceased ordinarily resided at the time of his death within the jurisdiction of a district court, or, having no fixed place of residence at the time of his death, left property within the jurisdiction of a district court. Succession certificates are granted to facilitate the realisation of debts and the transfer of securities, but are unnecessary unless a suit has to be instituted and a decree to be obtained. Banks, however, as a matter of practice, require a succession certificate. Section 9 of the Administrator-General's Act of 1913 provides that letters of administration shall be taken by the Administrator-General under certain circumstances, but this section excludes Indian Christians, Hindus, Mohammedans, Parsees, Buddhists, and those exempted by the Governor-General in Council under Section 332 of the Indian Succession Act of 1865. The effect of all the legislation is that probate, letters of administration, and succession certificates are taken only by a small portion of the population of India.

The best method to make all successions liable to taxation as in the self-governing Dominions and in most other countries is (1) to levy a succession duty on every person inheriting by will, succession, or settlement taking effect on the death of the settlor. Property below a minimum amount, say Rs.1000, may be exempted. The duty would be leviable on real and personal property. Unless there is an efficient administrative staff the duty on personal property may be evaded without difficulty. (2) Where the beneficiary who succeeds is a husband or wife of the deceased or is a lineal descendant or ancestor, a lower rate of duty may be levied than in the case of collaterals or strangers. Nearer relations should be taxed at a lower rate than more distant relatives, and a much higher rate of progression should be introduced than at present. (3) The person becoming liable to succession duty should be compelled by statute to report his liability within a specified time to the Collector of the District or to a suitable revenue authority in which the property movable or immovable is situated. As in Australia and other countries, various maximum penalties for offences may be prescribed. Thus in the Commonwealth Estate Duty Assessment Act, which came into force in December 1919, penalties were prescribed for (a) the obstruction of any officer acting in the discharge of his duty under the Act or the Regulations ; (b) the failure or neglect to duly furnish a return ; (c) the refusal or neglect to attend and give evidence when required ; (d) the making or delivering (knowingly and wilfully) of any false return ; (e) the under-statement of the value of an estate with intent to defraud ; (f) the evasion of assessment or duty by fraud or wilful act, default, or neglect. The Act also makes the last two indictable offences, and prescribes a maximum penalty of £500 or imprisonment for three years. (Sections 46, 47, and 48.) Similar provisions suitable to India will be necessary. In some cases the penalty clause may be double the duty. Fictitious partitions or gifts in anticipation of death, *benami* transactions (*i.e.* nominal transfers), should be guarded against, and the three years rule in Great Britain should be followed. When fictitious transfers are made within three years before the death of the transferor in order to evade payment of succession duty, such transferred property may be held liable to duty. Steps might be taken to see that partitions, gifts, etc., are *bona fide* and are acted upon. (4) The duty should be progressive,

increasing with the value of the property just as the duty decreases with the nearness of relationship. (5) As real property will come largely under this, the administration of the Act may be entrusted to the Revenue Agency, but in order to ensure effective administrative control from above, and to secure uniform procedure and taxation in the different provinces, the Board of Central Revenue may be entrusted with the care and management of the Act.

It is necessary that the tax should be fairly distributed among the various communities, and this raises the difficult question of the joint Hindu family, where, so long as the family remains joint, no individual member ¹ has, with rare exceptions, any interest which he can dispose of by will. Property is acquired not by succession but by survivorship. Acquisition by survivorship in the case of joint tenancies in England to-day is subject to duty.² In England, however, on the death of a joint tenant the surviving tenant becomes entitled to the property, but the son of the deceased joint tenant has no claim whatever. In the case of the joint Hindu family system the male descendants of a deceased coparcener are themselves coparceners. The exceptions just referred to regarding testamentary dispositions are, in the words of Manu: "what one brother may acquire by his labour without using the patrimony, that acquisition made solely by his own effort he shall not share, unless by his own will, with his brother". Manu also exempts a present received on marriage or with the honey mixture.³ Thus a joint family is joint in regard to property, religion, or worship, and joint in regard to the eating of food except when a brother has to live apart on account of his work in another place when a common mess is not possible, and even then the family still lives joint in property, religion, or worship, though not completely so in food. The two schools of Hindu lawyers—the Mitakshara and the Dayabhaga—differ in regard to the question of partition. According to the Mitakshara school, which is in force outside

¹ A member of a joint Hindu family can claim as a right (1) partition if a coparcener, coparcenary being limited to males within three generations in unbroken male descent, excluding the head of the family, and (2) maintenance. A wife, for example, can claim from the joint family property only maintenance.

² Section 2 (1), *b* and *d* of the Finance Act of 1894, and Section 3 of the Succession Duties Act of 1853.

³ Cf. Mayne, *Hindu Law and Usage*, chap. viii.; Maine, *Early Law and Custom*, chap. viii.

Bengal, the son immediately on birth becomes a co-owner or coparcener if he is within three generations, excluding the owner or the head of the joint family. These coparceners own the family property not as individuals but as a corporation. No single member possesses any ownership at all, except in self-acquired property as mentioned above. Under the Daya-bhaga system the members of the family are owners of their undivided shares, and the sons take no interest in the family property in the lifetime of their father. Their interest, in short, is acquired by death and not by birth. Under the Mitakshara system, on the other hand, the interest of a coparcener varies with the death or birth of other coparceners. The share of a coparcener in Bengal is treated as individual property which may be liable for debts. The share of the Mitakshara coparcener cannot be seized for his separate debts unless a decree is obtained and the property attached during his lifetime.¹ The difficulty thus arising in the case of Mitakshara coparceners could be surmounted by finding out what the interest of the deceased in the property would have been if he had demanded partition just before his death. The question arises, why not tax the acquisition² of property by birth as well as by death? Every coparcener acquires an interest in the joint family property by birth. Again, the interest of the remaining coparceners increases by deaths and decreases with births in the family. If the interest which is increased by death is taxed, why not compensate diminution of interest by birth? If a duty is to be levied at the death of each infant coparcener, Hindu susceptibilities will be wounded, and the duty would constitute a real hardship owing to the frequency of the levy. Acquisition by birth may be left alone, as the object is to impose death duties. No compensation can be given for diminution of interest by birth, as compensation at birth and duty on death would tend to cancel each other, and the tax would then be unproductive. Moreover, there is no case at all for such compensation if we consider the

¹ A mere attachment of the property before judgement will not suffice (*Subrao v. Mahadevi* (1914), 38 Bom. 105). See also *Laxman v. Vinayak* (1916), 40 Bom. 329. Cf. Mulla's *Principles of Hindu Law*, p. 254 (Bombay, 1919). There is, however, an exception in the case of a father's legal and moral debts, as sons are under a pious obligation to discharge such debts even from their share in the coparcenary property. *Op. cit.* p. 236.

² This term is not intended to cover compensation for diminution by birth.

question of equal taxation among different communities, *e.g.* Hindu, Mohammedan, Christian, or Parsee. Duties on the death of infant coparceners may, as will be seen later, be avoided altogether if the suggestion in the next paragraph is adopted. In order, then, to levy death duties on property acquired by survivorship, one of the following systems may be adopted.

The liability of the estate to duty may be limited to the occasion of the death of a coparcener of the oldest generation of the joint family. Thus in a family of three brothers and their children living in a joint family, succession duty would be payable only when each of the three brothers dies, and the duty on each occasion would be on the amounts *aggregating* to one-third of its total value. The duty would not be levied on the death of any of the children, but only when one of the three brothers dies. If the three brothers die, and if there were five children and some grandchildren remaining, then succession duty would only be levied on the death of any of the five children, and it would be levied on each occasion on one-fifth of the total of the estate, and so on for each generation.¹ The advantage of this scheme is that it leads to equality of taxation among the different communities, Hindus, Mohammedans, Parsees, Christians, etc. A possible objection is that the tax is levied on a higher share than what a deceased coparcener would be entitled to. For example, to take an extreme case, when a Hindu dies leaving sons but no ascendants or collaterals, the whole property will be taxed and not merely the father's share. This is, however, not of importance in view of the fact that the equality of taxation among communities far outweighs any possible disadvantages that may result. The higher share referred to above does not mean that Hindus are taxed on a higher scale than others. It only aims at placing Hindus on the same footing as other communities.

Other possible methods are (1) to levy taxation only when the head of the family² dies, or (2) when the surviving coparceners all belong to a lower generation than the deceased

¹ The succession duty is not to be levied on the coparcener's share as a whole, but on the amounts by which the survivors are benefited. This in the aggregate will come to the share of the deceased coparcener.

² By "head of the family" in this proposal is meant a coparcener of the oldest generation of the family, and not any member of a lower generation, although the latter may look after the family affairs.

coparcener. The first of these alternative methods may be given effect to by taxing either the whole of the property or the share that would have accrued to the head of the family if partition had taken place immediately before his death. The following example may be taken. Suppose A is one of three brothers, and if A dies the whole of the property will be subject to the tax. B then becomes the head of the family, and when B dies the whole of the property is again taxed. When C becomes the head of the family and dies, the whole property pays a tax for the third time. In England the property descends to the sons. In India, however, the property by survivorship goes to the sons or brothers. In the latter case, therefore, this would tax the brother who dies not merely according to his share of the property, but according to the value of the shares of the remaining brothers and sons, or coparceners, which would mean in effect a heavier burden on the estates of Hindus than would, perhaps, be justified. If, on the other hand, the share of the deceased head of the family alone is to be taxed, a part of the property would escape taxation during each generation. For example, if C dies before A and B leaving sons, no tax will be levied as C is not the head of the family. On A's death one-third of the property will pay the tax. On B's death another one-third pays the tax, as he was the head of the family. Thus two-thirds of the property only pays the tax in a generation and C's one-third escapes taxation.

The alternative scheme is to tax property when the coparceners all belong to a subsequent generation than that of the deceased. Thus A and his sons B, C, and D form a joint Hindu family. A dies; B, C, and D pay duty on A's share. Subsequently B dies, but no duty will be paid as C and D belong to his generation. C's son E dies during C's lifetime. No duty is payable. The drawback to this method is that Hindus will be taxed less than other Indians because the tax is to be levied only when all the coparceners belong to a subsequent generation. It is suggested that to compensate for the fewer occasions on which the duty will be leviable a higher rate may be levied in such cases. This presupposes that it will be possible to arrive at the number of occasions on which the duty is not levied on the Hindu as compared with other communities. In the absence of this the fixing of a higher rate of duty will be somewhat arbitrary.

All things considered, therefore, the first proposal seems to be the most suitable one for adoption.

One proposal is to levy in the first instance a succession duty on acquisition by legacy and by succession, but not by survivorship. It may also be feasible to extend the cases in which probate and letters of administration should be taken out, when a complete statement of accounts of the deceased's property will be required. In regard to the former this is only a half measure, and the second will not be an estate duty proper as levied in other countries.

Next with reference to the levying of an estate duty on property in India passing on death by succession, survivorship, or settlement. For purposes of estate duty all property passing on death may be aggregated and treated as one. The liability to pay duty may be determined by gross assets, but the tax may be collected on the net value of the property, due allowance being made for liabilities. Arrangements may be made, as in Great Britain, Germany, Japan, Chile, and other countries, to reduce the amount of estate duty if it falls due within a short period after the payment of the previous duty. For example, when the second death occurs within one year of the first death the duty may be reduced by 50 per cent, and by an annual reduction of 10 per cent for each year down to 10 per cent when it occurs within five years of the first death. This reduction need not be granted in the case of joint family property passing by survivorship when deaths occur among members of the same generation, as in such instances the share of the deceased coparcener only and not the whole property is to be taxed. This is, in effect, an estate duty, as it falls on the whole share of the deceased coparcener.¹ In the case of non-joint families it will fall on the whole estate. In Great Britain, if property consisting of land or a business passes on death a second time within five years of the first death, allowances are made from 50 per cent where the second death occurs within a year of the death, down to 10 per cent where the death occurs more than four years later than

¹ The distinction between an estate duty and a succession duty is that the former falls on the deceased's estate as a whole, while the latter falls on the shares of the successors. In the case of a Hindu joint family, an estate duty may be levied on the deceased coparcener's share in the estate as a whole, and a succession duty on the different parts of the deceased coparcener's share devolving on the surviving coparceners.

the first death. In the United States by a law of 1918 no tax is charged upon a second succession if occurring within five years of the succession upon which estate duty has been paid. The fees chargeable may be graduated. The Commonwealth Estate Duty Assessment Act of Australia fixes, for example, 1 per cent where the total value of the estate after deducting all debts exceeds £1000 and does not exceed £2000, and 1 per cent with an additional percentage of one-fifth of a pound for every £1000 or part of £1000 in excess of the sum of £2000, but so that the percentage shall not exceed 15 per cent. Duty is levied at two-thirds of these rates on so much of the estate as by will, intestacy, gift *inter vivos*, or settlement passes to the widow or children or grandchildren of the deceased person. Arrangements should, as in the case of the succession duty, be made for the reporting of all liability to estate duty when it occurs.

9. THE CROWN COLONIES

In Ceylon the collection of estate duties has been in force since July 1919.¹ The estate duty includes property of which the deceased was at the time of his death competent to dispose. The Commissioner of Stamps is entrusted with the administration of the Ordinance, but an appeal lies against his decision to the district court. The whole property of the deceased is liable to estate duty, including property in which he had an interest at the time of his death to the extent to which a benefit accrues or arises by the cesser of such interest, property to which the deceased was once absolutely entitled which owing to some disposition of his passes by survivorship to another. Property passing to *bona fide* purchasers for full value, small annuities not exceeding Rs.250, and books and works of art of national interest bequeathed to public bodies are not subject to duty. Property reverting to the settlor under certain circumstances is also exempted. A statutory obligation is laid on the executor to furnish within twelve months of the death of the deceased a full and true statement of the property of the deceased, penalty for non-compliance being double the duty, and a person making a

¹ Ordinance No. 8 of 1919, Government Record Office, Colombo. The rules under this Ordinance are published in the *Ceylon Government Gazette* of 23rd June 1922.

false affidavit is punishable for giving false evidence. For purposes of duty the whole property is valued to arrive at the price which it would fetch in the open market. The rates of duty vary from 1 per cent on amounts exceeding Rs.1500 but not exceeding Rs.7500, 2 per cent on amounts exceeding Rs.7500 but not exceeding Rs.15,000, 3 per cent on amounts exceeding Rs.15,000 but not exceeding Rs.75,000, 4 per cent on amounts exceeding Rs.75,000 but not exceeding Rs.150,000, 5 per cent on amounts exceeding Rs.150,000 but not exceeding Rs.300,000, 6 per cent on amounts exceeding Rs.300,000 but not exceeding Rs.600,000. An estate of the value exceeding Rs.15 lakhs and not exceeding Rs.25 lakhs would pay 10 per cent, and an estate above Rs.52½ lakhs but not exceeding Rs.60 lakhs pays a duty of 15 per cent, and the maximum of 20 per cent is levied on an estate of Rs.150 lakhs and over. In addition there is a separate settlement estate duty where the property is settled.

In the Straits Settlement under the Stamp Ordinance of 1907 there is a progressive rate which extends to 7 per cent, and in Hong Kong¹ similar legislation has been in force from 1901 and the rate varies from 1 to 8 per cent. In the Bahamas fees are levied on the value of the estate and do not exceed 2 per cent.² In the Barbados a duty is levied by the Estates Duty and Absentees Act, 1895. In Trinidad and Tobago there is the Will and Legacy Duty Ordinance of 1888, where the lineal ancestor pays less per cent than do others, the maximum rate being 6 per cent. In British Guiana there is the Tax Ordinance of 1892. In Jamaica, probate, legacy, and succession duties are payable, and in the Leeward Islands there is the Stamp Act of 1887. In the Falkland Islands,³ Fiji,⁴ and Sierra Leone⁵ there is similar legislation. In the Falkland Islands the maximum rate is 4 per cent under the Probate and Unrepresented Estate Ordinance, 1901. In Fiji succession duties vary from nil to 10 per cent under legislation first imposed in 1882.

¹ Stamp Ordinance, 1901, Amending Act, 1902, and Acts of 1909.

² The Amended Fees Act, 1899, 62 Vict. c. 14.

³ Probate and Unrepresented Estate Ordinance, 1901.

⁴ Stamp Ordinance, 1882.

⁵ Stamp Duty Consolidation and Amendment Ordinance, 1905.

10. THE UNITED STATES

In the United States there is an Inheritance Tax ¹ both Federal and Commonwealth. A reference has already been made to the very rapid increase in American inheritance taxes that has taken place since the adoption by the State of New York in 1885 of this form of taxation. Mr. Harrington, Inheritance Taxes Counsel of the Wisconsin Tax Commission, describes the Wisconsin law as typical of the laws prevailing in most of the states. The tax is measured by the amount of property which the beneficiary receives. "The primary rate is 1 per cent when the transfer is to husband, wife, children, father, or mother; 1½ per cent to uncles, aunts, nieces, and nephews; 3, 4, and 5 per cent to relatives further removed, according to degree of kindred; and 5 per cent to strangers in blood, corporations, and other organisations, except municipal, religious, charitable, and educational corporations within the State, which are exempted. The above primary rates apply to the first \$25,000 received by the beneficiary. The next \$25,000 bears a rate of one and a half times the primary rate; the next \$50,000 twice the primary rate; the next \$100,000 two and a half times the primary rate, and all above \$500,000 three times the primary rate. Thus it will be seen that a distant relative or a stranger in blood will pay 15 per cent upon the excess over a half-million dollars that he may receive. An exemption from the tax is allowed of \$10,000 to a widow, \$2000 to each of the other relatives named in the first section, and lesser amounts to more distant relatives, down to \$100 to those in the fifth class. These exemptions are taken out of the first \$25,000. The Inheritance Tax is imposed and collected during, and as a part of, the settlement of estates in the County or Probate Courts, and is usually paid by the executor and charged against the share which he is required to pay over to each beneficiary upon such settlement."² To a question: "If a decedent lived in one state and owned property in another state, to which state should the tax be paid?" Mr. Harrington answers: "Quite early in the administration of the law it was decided that, if the property is real estate, the tax is due to the state where the land is located. This

¹ *Inheritance Tax Service*, published by Prentice-Hall, Incorporated 70, 5th Avenue, New York.

² *Annals of the American Academy of Political and Social Science*, vol. lviii. March 1915.

rule has been affirmed repeatedly, and has received general acquiescence. Where, however, the foreign property is personal, it was held to follow the residence of the owner and to be taxable in the state where the deceased had his domicile. But numerous states held that the property was taxable in the state where located, and in such cases the same property was subjected to double taxation. After eliminating all real estate, and all personal property located in the state of the owner's domicile, the property so subjected to double taxation is relatively unimportant in amount and not sufficient in any sense to serve as a basis for condemnation of the law. Nevertheless possible double or multiple taxation is a problem of sufficient moment to demand the careful attention of students and legislators. The recent amendment to the Wisconsin Law (Section 1087-11, Sub-sections 3-8, Statutes of 1913) is intended as an important step towards the elimination of double taxation, without surrendering the right to tax the transfer of securities representing Wisconsin corporate property. It provides in substance that the stocks, bond, and other securities of a non-resident shall be subject to the Inheritance Tax in this state at a value proportionate to the value which the Wisconsin assets of the corporation bear to the entire assets. It is true that this law does not cover the entire situation, nor have its administrative problems been fully worked out. Argument is frequently made on behalf of the Inheritance Tax as an economic measure, designed in some degree to reduce 'swollen' fortunes. There is no basis for such argument; and a state tax heavy enough to have that effect would probably drive much of the liquid capital out of the state, and prevent capital from coming in." The Federal tax levied by the Federal Government is in the nature of an estate duty.

11. JAPAN

The law in Japan dates from 1905, and the taxation increases according to relationship and also according to the size of the estate. It varies from 0.5 per cent on estates of 2000 yen to 2.5 per cent on estates over 150,000 yen for near relatives, from 0.6 to 3 per cent for less near relatives, and from 0.8 to 4 per cent in the case of distant relatives. For every additional 100,000 yen over 200,000 yen an additional tax of $\frac{5}{10000}$ is levied.

When the tax occurs within five years the amount of succession taxes corresponding to the amount of tax previously collected is remitted. There is a separate tax on amounts bequeathed which also varies according to the grade of relationship. For the first grade the rate is 1.2 to 5.0 per cent ; for the second grade 1.3 to 5.5 per cent ; and for the third grade 2.0 to 6.5 per cent.

12. FRANCE

In France ¹ although succession duties have been in existence since 1790 their interest arises mainly from the history of such taxes from the passing of the law of 1901. In that year the net value was the basis of assessment, an allowance being made for the deduction of debts, and, what is very important, the scale of duties was fixed on a definite basis from that year. The duty varies with the relationship and the net value of the property received by the beneficiary, and in some cases is over 20 per cent. Where the property devolves upon one person for a life tenancy only, the respective interests are determined in accordance with an arbitrary scale, which is according to the age of the beneficiary. The age groups are, unfortunately, at 10-year intervals, and the value of the life interest to the age of the usufructuary not exceeding 29 $\frac{7}{10}$ ths of the whole property, over 20 but not exceeding 30 $\frac{6}{10}$ ths, over 30 but not exceeding 40 $\frac{5}{10}$ ths of the whole property, over 40 but not exceeding 50 $\frac{4}{10}$ ths of the whole property, over 50 but not exceeding 60 $\frac{3}{10}$ ths of the whole property, over 60 but not exceeding 70 $\frac{2}{10}$ ths of the whole property, and over 70 $\frac{1}{10}$ th of the whole property, the value of the reversion being the difference.

13. GERMANY AND OTHER COUNTRIES

In Germany practically all states levy succession duties.²

¹ Petit, *Manuel pratique de déclarations de successions*, 2nd edition, 1911 (Paris) ; Pellerin, P., *French Law of Wills, Probate, Administration, and Death Duties, particularly in regard to Estates of Englishmen deceased in France*, London, Stevens & Sons, Ltd., 1909 ; Naquet, E., *Commentaire de la loi du 25 février, 1901 (Réforme du régime fiscal des successions, etc.)*, Paris (Larose & Forcel), 1901 ; *L'Impôt des successions*, Paris (Imprimerie Nationale), 1922. An official codified text of the laws.

² Marcus, J., *Das neue Erbschaftssteuergesetz vom 10. September 1919, nebst den Ausführungsbestimmungen*, Berlin (Industrieverlag Spacht und Linde),

In Holland ¹ and Belgium ² there are special transfer duties upon the estate of deceased persons in addition to succession duties. In Switzerland ³ there is a tax in the various cantons at varying rates, and Switzerland, as is well known, was for long the only country with progressive succession duties. Italy's ⁴ succession duties bear a family resemblance to those of France, as also do certain of her other taxes. Norway,⁵ Sweden,⁶ and Chile have similar legislation.

3rd edition, 1922; Zimmermann, F. W. R., *Das Erläuterungsbuch zum Erbschaftssteuergesetz vom 10. September 1919 unter Berücksichtigung der Ausführungsbestimmungen des Reichsministers der Finanzen*, Munich and Berlin (J. Schweitzers Verlag), 3rd edition, 1921; Schachian, H., *Das Erbschaftssteuergesetz nebst Ausführungsbestimmungentabellen und angrenzenden Rechtsvorschriften*, Berlin and Leipzig, Walter de Gruyter und Co. (Vereinigung wissenschaftlicher Verleger), 3rd edition, 1922.

¹ Tjeenk Willink, *Het nederlandsch Belastingrecht*, vol. 4, *De Successiewet* (Zwolle, 1923).

² Thomas, E., *Coordination doctrinaire sur les droits d'enregistrement, de timbre, de greffe, d'hypothèque et de succession en vigueur en Belgique au 31 décembre 1913*, Brussels, Établissements E. Bruylant, 67 rue de la Régence.

³ Jaeggy, P. C., *Die Erbschafts- und Schenkungssteuer in der Schweiz*, Berne (Stampfli), 1919; Cörenville, M. de, *Les Impôts en Suisse* (Assiette—Quotité—Mesures d'exécution), Lausanne, Corbaz, 1st edition, 1898.

⁴ Garelli, Alex., *L'Imposta successoria*, Turin, 1st edition, 1896. A standard work.

⁵ Thomle, J. I., *Regulations concerning the Inheritance Duties*, Christiania, J. M. Stenerson's Forlag, 1910.

⁶ Royal Ordinance of 19th November 1914, relating to a tax on Inheritance and Gifts (No. 381/1914).

CHAPTER XXIV

OTHER DIRECT TAXES AND THE TAXATION OF SURPLUS

THE surface of the subject of direct taxation has now been scratched, but there remain for discussion other direct taxes of varying importance. It is proposed to deal with (i.) that unpopular form of taxation, poll, or capitation taxes ; (ii.) direct consumption taxes, such as those on inhabited houses, huts, carriages, motor cars, and men-servants ; and (iii.) the taxation of surplus. In recent years, Governments have devoted considerable attention to the taxation of surplus in the form of unimproved land duties, corporation taxes, and excess profits duties. The War period threw a new light on this aspect of tax revenue, which is mainly, if not entirely, in the nature of direct taxation. The Excess Profits tax in the United States yielded in 1918 the largest annual amount ever produced in any country by a single tax, 2505 million dollars or £511 million sterling. The British tax in four years brought into the Exchequer nearly £982 million sterling. There is in regard to the taxation of surplus a great harvest for the Finance Minister's sickle.

1. POLL OR CAPITATION TAXES

Poll, head, or capitation taxes are of very ancient origin. Outside the United States, Sweden, and to a much less extent the Union of South Africa and one or two colonies, the tax is to-day merely of academic or historic importance.¹ Poll taxes were levied by the Romans on the Britons, and known as the *capitatis*

¹ Cf. "A poll tax is neither productive nor equitable, and stands as a relic of past methods rather than as a subject of present importance" (Hadley, *Economics* (p. 474), New York, Putnam's Sons).

humana. The first poll tax of which there are details in English history is the tallage of groats, 1377. This tax is said to have been modelled on the French tax. Dutch financial experts were never in love with it on account of its inequalities. The tax of 1377 was "four pence, to be taken from the goods of each person in the kingdom, men and women, over the age of fourteen years, except only real beggars". The tax of 1380 was granted and included "every merchant stranger". The two Dukes of Lancaster and Bretagne were assessed at 10 marks each (£6 : 13 : 4), Earls at 6 marks (£4), and the list included barons, baronets, esquires, members of the legal profession, the business community, farmers, down to "every married man (not of the estates foresaid) for himself and his wife, and every man and woman sole over the age of sixteen years, except real beggars 4d." The clergy and the unmarried were also assessed. "Commissioners, appointed to assess and collect the tax in the various counties and towns, were sworn to faithful performance of their duty; but so difficult did the collection prove to be, that it was necessary to get in the arrears by farming the tax. The farmers acted with rapacity and insolence. Endless disputes occurred regarding the limit of age."¹ The Wat Tyler rebellion, it is said, arose from this impost on account of a dispute over the age of a girl whose exemption was claimed as being under fifteen years. Poll taxes were also levied on aliens, and a tax of this description was granted to Henry VI. for life. In the poll tax levied in 1513 in Henry VIII.'s time wages were taken as one of the measures of taxable capacity.² Under Charles I. a poll tax was voted in 1641 for payment of the Northern Army, and levied upon persons "according to their ranks, dignities, offices, callings, estates, and qualities". It varied from £100 on a duke to 1s. on those with an income of £5 per annum and 6d. on persons below this amount. Poll taxes were levied in 1660, 1666, 1677, and especially in William and Mary's reign up to the year 1698, when they were finally discontinued. Samuel Pepys wrote in his Diary, when the collectors in December 1660 demanded 10s. for himself and 2s. for his servant, that he paid the amount "without dispute", and he naïvely adds, "I put by £10 for them, but I think I am not bound to discover myself". No wonder Bacon

¹ Dowell, *History of Taxation and Taxes in England*, vol. i. p. 113.

² Every man who had 40s. in wages—12 pence.

speaks of the English as " the least bitten in purse of any nation in Europe ".

The tax in the United States is in force in every State except Columbia and Maryland. It is usually levied on all males (and in sparsely populated Wyoming also on females) between the ages of 20 or 21 years and 45 or 60. The proceeds are used for State or for local purposes (*e.g.* roads and schools) or both. Evasion, however, is considerable. In other countries the tax is of little importance. In India in Mogul times poll taxes were levied,¹ and in hill districts such as the Naga and Lushai districts of Assam are still known. In some countries the payment of the tax is in the nature of a registration fee or a preliminary to the vote as in certain states of the American Commonwealth. In the Union of South Africa a poll tax is levied in the Transvaal and the Orange Free State, and a hut tax in Cape Province, Natal, and the Transkeian territories. In the Transvaal the levying of a poll tax is governed by the Poll Tax Ordinance (No. 7 of 1921), the Poll Tax Amendment Ordinance (No. 9 of 1922), and the Poll Tax (Penalty) Ordinance (No. 2 of 1923). Of these the first Ordinance was challenged in the law courts and declared *ultra vires* so far as natives were concerned. The poll tax is now payable by non-native adults residing in the Province for at least ninety consecutive days preceding the 30th June of the year for which tax is payable. Women who do not pay Union Income Tax, and students having no income of their own and attending recognised educational institutions for three months immediately before the date when the tax becomes due, are exempted from the poll tax. The rates of tax are, for married individuals, £1 : 10s. plus 15 per cent of the Union normal tax and super tax paid for the year preceding the year for which the poll tax is payable; for unmarried individuals below twenty-five years of age who do not pay income tax, £1 : 10s., and for others £2 : 5s. plus 22½ per cent of any Union Income Tax paid. If the tax is not paid within a specified date a penalty of 10 per cent is levied for each month or part of a

¹ The tax was on adult males only. In 1564, for example, Akbar of his own accord, and ten years before he made the acquaintance of the famous Abul Fazl, remitted a large source of revenue, viz. the poll tax on non-Muslims. Abul Fazl states that it was a very great source of revenue. It was re-imposed by Aurangzeb in 1679. According to Vincent Smith the tax had been fixed originally by the Kalif Omar in three grades. *Vide* p. 66, *Akbar the Great Mogul*, Vincent A. Smith (Oxford Clarendon Press, 1919).

month in default. Employers are entitled to deduct the tax from the wages of their employees if the tax is recovered from the former. The taxes cannot be considered productive.¹

The main objections to capitation taxes are that they are inconvenient and do not take into account the real ability of the taxpayer to pay, and also that they are unproductive and expensive to collect. In Adam Smith's view "capitation taxes are levied at little expense, and, where they are rigorously exacted, afford a very sure revenue to the State. It is upon this account that in countries where the ease, comfort, and security of the inferior ranks of people are little attended to, capitation taxes are very common. It is, in general, however, but a small part of the public revenue, which, in a great empire, has ever been drawn from such taxes; and the greatest sum which they have ever afforded, might always have been found in some other way much more convenient to the people."²

2. DIRECT CONSUMPTION TAXES

Direct consumption taxes are strikingly insignificant in modern tax systems. Indirect consumption taxes have taken their place. In these days of industrial progress it is, for example, more easy, and certainly more productive, to collect revenue from taxes imposed at a particular stage of manufacture than from a scattered body of consumers. Moreover, direct consumption taxes are usually on luxuries or non-necessaries. Taxes, then, on these are inelastic and unproductive, especially when compared with excise duties.

In Great Britain the direct consumption taxes are licences³ on carriages and motor cars, armorial bearings, male servants, together with the game, gun, and dog licences. The inhabited house duty, abolished from 1924 to 1925, was found to be a convenient mode of assessment on account of the universal use of

¹ Native taxes in 1922-23 were £840,000 only out of a total revenue of £28,695,000.

² *Wealth of Nations*, Bk. V. chap. ii. pt. ii. art. iv. Montesquieu (*L'Esprit des lois*, bk. xiii. chap. xiv.) thinks that these taxes are looked on as badges of slavery, because they are fixed at so much per head. Adam Smith (Bk. V. chap. ii. pt. ii. art. ii.) remarks that "every tax, however, is to the person who pays it a badge, not of slavery, but of liberty".

³ Consumption licences are to be distinguished from trade licences, e.g. those granted in Great Britain to distillers, brewers, auctioneers, house agents, pawn-brokers, and dealers in plate.

houses. The house rent paid is usually a good criterion of one's income, and accordingly of one's taxable capacity. Probably on account of the difficulty of obtaining actual rents, recourse was had to the taxing of hearths and windows. The former tax was abolished after the Revolution on account of its inquisitorial nature, and a tax of two shillings on every inhabited house, with additional taxes if there were ten windows or more, was imposed. A tax on the basis of windows is to be condemned as a tax on ventilation. This was afterwards modified to a window tax from 2d. to 2s. per window.¹ The objection to this type of tax is that it falls more heavily on the poor than on the rich. Until April 1924 the inhabited house duty was a permanent direct tax upon occupiers of dwelling-houses based on the annual letting value. In the administrative county of London the annual value depended on the quinquennial valuation under the Valuation Metropolis Act, 1869. The last new assessment was made in 1921, and for the rest of Great Britain a new assessment came into force for 1923-24, the previous assessment having taken place in 1910. The rate of duty² for private dwelling-houses, *i.e.* except for farm-houses, hotels, public-houses, coffee-shops, residential shops, or lodging-houses, was 3d. in the £ if the annual value is £20 or more and does not exceed £40, exceeding £40 and not exceeding £60, 6d., and exceeding £60, 9d. For farm-houses, hotels, public-houses, coffee-shops, residential shops, or lodging-houses the rates within these limits were respectively 2d., 4d., and 6d. A house let in tenements or flats³ and inhabited by two or more persons or families was usually subject to one assessment only, except in certain cases, *i.e.* a house providing separate dwellings may be the subject of a separate assessment for each dwelling of an annual value not exceeding £60. The taxation of houses is hardly a suitable source of revenue for a State or Federal Government, which should tax only incomes from houses, leaving the taxation of houses to local bodies. The house duty yielded in 1923-24 only £1,950,000 out of a total tax revenue of nearly £856,000,000.

¹ "The window tax, as it stands at present (January 1775), over and above the duty of three shillings upon every house in England, and of one shilling upon every house in Scotland, lays a duty upon every window, which, in England, augments gradually from twopence, the lowest rate, upon houses with not more than seven windows, to two shillings, the highest rate, upon houses with twenty-five windows and upwards" (*Wealth of Nations*, Bk. V. chap. ii. pt. ii. art. i.).

² 1921-22.

³ 3 Edw. VII. c. 46, § 11.

The tax was abolished in 1924, and the British Chancellor of the Exchequer remarked that it was to large sections of the working professional classes of very moderate means an unnecessary and irritating addition to more necessary and appreciable burdens. He also said that the remission would be a greater relief to the married man with an income of £500 a year than a reduction of 6d. in the income tax. It will cost £1,750,000 this year, and £2,000,000 in a full year.

The present duties on carriages, menservants, and armorial bearings belong with the house duty to a class of taxes hitherto known as the assessed taxes. Before 1785 the taxes on carriages and male servants were under the commissioners of excise, while the then new taxes on saddle, carriage, and race-horses were under the commissioners of stamps and were termed "unstamped duties of stamps". The window tax and inhabited house tax were under the commissioners for the affairs of taxes. In 1785, to prevent fraud and evasion and to secure more efficient administration, Pitt placed all these taxes which fell on the luxurious expenditure of the rich under one authority, the board of taxes,¹ and these taxes, viz. those on houses, carriages, menservants, saddle and carriage horses, and race-horses came to be known as the assessed taxes. Hair powder and armorial bearings were subsequently added. Those on horses and hair powder have been remitted. Dog and sporting licences, although not assessed taxes proper, are analogous. The tax on motor vehicles is now a very productive tax. The present system of motor taxation was recommended by a representative Departmental Committee as being the fairest and best. There have been few complaints other than those raised against any form of taxation. Special rates are fixed for taxis, tractors, and for cars used solely for the conveyance of goods in the course of trade.² Fire-engines and ambulances or road-rollers kept by a local authority are exempted from taxation. Other motor vehicles³ not exceeding

¹ 25 Geo. III. c. 47.

² These are taxed £10 when not exceeding 12 cwt. in weight; not exceeding 1 ton, £16; not exceeding 2 tons, £21; not exceeding 3 tons, £25; not exceeding 4 tons, £28; and exceeding 4 tons, £30.

³ The number of motor vehicles in the world is stated to be over 12½ million, of which 10,449,000 are in the U.S.A., 498,000 in the U.K., 469,000 in Canada, 236,000 in France, 81,000 in Australia, 70,000 in Argentina, 60,000 in Germany, 53,000 in Italy, and in India 46,000; other countries, 367,000. In the chief countries the feasibility of this form of taxation is of course easiest.

6 h.p. or electrically propelled pay £6, and exceeding 6 h.p. for each unit or part of a unit of h.p., £1. The taxation of road vehicles brought into the Exchequer over £11,000,000 in each of the last two years,¹ and this method of taxation is worthy of examination in other countries. The yield from some of the consumption licence duties and the number of licences issued are given below :

	1913-1914.		1922-1923.	
	No.	Yield.	No.	Yield.
		£		£
Male servants . . .	248,277	186,197	169,277	126,908
Armorial bearings . .	53,802	69,542	39,316	47,583
Gun licences . . .	226,882	113,377	267,896	133,881
Dog licences . . .	1,978,440	741,902	2,292,357	859,621

The licences for male servants and armorial bearings are below the pre-War figures, while gun and dog licences are considerably above the pre-War figures. The Commissioners of Customs and Excise collect the licence duties for Scotland and the County Councils administer these in England.

The French taxes assimilated to the direct taxes, an old group of taxes, certainly those on carriages, horses, and mules, also belong to the class of direct consumption taxes. The French tax on doors and windows, annulled for State purposes² by the law of 31st July 1917, when the scheduled income taxes took its place, was also a direct consumption tax. This is another of the many examples of the growing disuse of the direct consumption tax in any State or Federal revenue system. Such taxes for administrative and other reasons are, with rare exceptions, more suited for local taxation.

¹ Motor cars, £5 millions; commercial vehicles, £3 millions; motor cabs, £2 millions; motor cycles, £952,000. The yield of these and other licences was in 1888 transferred to the Local Taxation Accounts. The Finance Act of 1911 made the surplus of the receipts from carriage licences, including motor cars, over the year 1908-9, payable to the Exchequer.

² The State also collects additional taxation (*centimes additionnels*) for the departments, communes, bourses, chambers of commerce, and for the working-men's accident guarantee funds. In 1914, when the real estate taxes were changed, it was arranged that the Government should continue to collect (on the old basis) the *centimes additionnels* for local treasuries until a new plan could be arranged.

3. THE TAXATION OF SURPLUS

Countries which practise first-rate finance have in the present century, especially in the last decade, given considerable attention to the taxation of surplus. The theory of taxable capacity is now better understood than before the War, largely owing to the fact that Governments and their expert officers have been compelled to give far greater attention to the subject, owing to the necessity for increased revenues. The idea is seen in the *Principles of Ricardo*,¹ but even in the *Principles of John Stuart Mill* ² (who first used the term "unearned increment") the taxation of surplus is still in reality undeveloped. To-day it is generally recognised as fair to tax that part of an individual's income which is not the result of any useful economic effort on his part (such as the expenditure of capital, labour, or skill) without interfering with production. Surplus includes excess profits or other profits containing an unearned increment brought about by war or by other factors such as the general progress of society. In other words, where an enhancement of value has taken place through Government or the general progress of society, which may be said to have created it, is it not right that the taxing authority should appropriate part of the surplus when profits are above those necessary to attract capital and to maintain production?

The United States has been far in advance of any other country in the taxation of surplus. Property in the neighbourhood of cities has for long been subject to betterment charges, or, as they are called, special assessments. A special assessment is, as defined by Seligman, "a compulsory contribution levied in proportion to special benefits designed to bear the cost of special improvements to property undertaken in the public interest".³ Land in America, unlike that in Great Britain, is also taxable on its selling value, rather than on its rental value. The most striking illustration of surplus value is that afforded by land near or in great cities. John Jacob Astor in New York, and the Duke of Westminster in London, were enormously

¹ Chapter x.

² Book V. chap. ii. section v.

³ Seligman, *Essays in Taxation*, p. 414. Recoupment is a method prevailing in some countries by which municipal authorities obtain the benefit of a rise in property by acquiring compulsorily the land at a valuation which does not include the prospective increase in value which will be due to improvement.

enriched by the possession of urban sites. The growth of New York and London gave the land an increased value without any presumable effort on the part of the owners of the property. The supply of the land would not be reduced by the tax. Land sells at £175,000 an acre inside London and £10 per acre thirty miles outside. Similarly, railways with their terminal facilities in centres of large population and other land, which regularly appreciates, as population and industries have a wonderful way of growing along a railway line, enjoy unearned increment. Why should the State not tax without any disastrous effects on production part of the surplus wealth not the reward of any effort of the owner? In this chapter we include under the taxation of surplus: (1) the unearned increment of land; (2) the taxation of the corporation surplus, or, as it is sometimes called, the corporate excess or the franchise; and (3) the taxation of excess profits. With each of these methods of taxing surplus we shall briefly deal.

4. THE TAXATION OF UNEARNED INCREMENT

Firstly, with regard to the taxation of unearned increment in land, it is humbug to say that the owner should not share a *portion* of this value with the authority which created it, and it is unfair to allow him to escape his proper share of burdens, even if the land remains vacant or is used for agricultural purposes. The taking by taxation of a slice out of the surplus value of agricultural land for the gain of the community is, as is to be expected, no easy matter and is more difficult than in the case of urban land or railways. There are economic factors and administrative difficulties which require careful weighing. The amount of capital invested in the soil and the estimation of the normal return on it necessitate unusual watchfulness even in countries where, as in India, the State has never parted with its ultimate right of public ownership in the land. These obstacles are less where the State proposes to take only a share of the surplus and not the whole of the accretion. The official valuers, moreover, have to be of high intelligence and of unimpeachable honesty. The periodical settlement of land in India shows that it is possible to distinguish between that part of the value of land which is and that which is not due to

improvements. Taxes, therefore, on the former would not be likely to check the development of land. It is also possible to have settlement officers of high intelligence and probity as the Indian Civil Service has produced since the early nineteenth century.¹

In recent years in Great Britain there has been a movement to tax land values. In 1901 a Royal Commission on Local Taxation suggested a local tax on site values in England, and in 1904 and 1905 bills to this effect reached their third reading in the House of Commons. In 1906 the bill passed its second reading in the House, and it applied to Scotland only. It was withdrawn in favour of a local valuation bill which was rejected by the House of Lords in 1907. In 1909 a Liberal Government took up the scheme under Mr. Lloyd George of the taxation of land values, and the Finance Bill of 1909-10, which was passed by the House of Lords on 29th April 1910, imposed four duties. An increment value duty of 20 per cent was levied on the increase in the value of land over 10 per cent payable on each occasion on which land changed hands by sale or death, or when a lease was made for a period of more than fourteen years. In the case of land held by corporations which, therefore, does not change hands, the tax was levied every fifteen years, the owner being given permission to pay in fifteen yearly instalments. On all of these occasions the value of the site was ascertained as compared with the value in the basic period, namely, on 30th April 1909. This necessitated a very careful survey more complete than the Domesday Book of the eleventh century. In addition to this increment value duty there was the undeveloped land duty of half a penny in the pound on the site value of undeveloped land, land being considered undeveloped when there were no dwelling-houses or buildings for the purpose of business, trade, or industry other than agriculture, or was without glass-houses or green-houses. There were also two other duties—the reversion duty of 10 per cent on benefits accruing to the lessor by reason of the termination of the lease, and the mineral rights duty of 5 per cent on the rental value of all rights to work minerals, and of all mineral wayleaves. Agricultural land was excluded from the increment value

¹ It must not be thought that even India, with its developed land system, taxes to any very great extent unearned increment.

duty if its value was no higher than its market value for agricultural purposes only. The undeveloped land duty was not applicable to any land whose site value did not exceed £50 per acre. In 1920 a Select Committee reported. The cost of the valuation of land amounted to £2,178,397, and the total revenue for the first four years from the increased value, the undeveloped land duties, and the reversion duty amounted to £1,390,000. On account of the disappointing yield the land value duties were abandoned in 1920, and the mineral rights duty alone continued in March 1924. The question, however, was again under consideration as a deputation was received by the Chancellor of the Exchequer on the 26th of March 1924, which urged the introduction of a measure for the taxation of land values accompanied by a simplification of the valuation and the re-equipment of the Valuation Department. The deputation urged on behalf of the public that early steps should be taken to impose a levy upon the social economic value of the land which was now appropriated by individuals. The Chancellor of the Exchequer (of the Labour Government) agreed with the deputation as to the theory, the justice, and the necessity for the rating and taxation of land values, and said that it was a reform to be carried out at a fitting moment. He announced in his Budget speech that Government would introduce a bill to tax land values and to reorganise the Land Valuation Department. Some countries have not considered taking in the form of a tax a share of the unearned increment, nor have they taxed unimproved land as in Australia and New Zealand. The recent movements in not a few countries show that this is now receiving notice. It is at times difficult to say how far land has risen in value owing to "improvements", and how far it has risen apart from such improvements. If a heavy tax is placed on improvements it may check the development of the land.¹ It is also sometimes said that a special tax of this nature on land is inequitable as it taxes one class of investors, namely, those investing in land. It is claimed that "in view of the fact that the legislature has for a long time by repeated enactments compelled trustees, institutions, mutual societies, and other bodies and persons who are in a fiduciary position towards a vast multitude of the most dependent and helpless

¹ Chapter XX. p. 222.

portion of the people, to invest the funds which they hold on their behalf in a limited class of specified securities, of which real property is the most important item, it would be a grave breach of public trust and good faith to so specially tax and penalise that particular class of property as to seriously reduce its value, when and where it cannot be shown that the owners of such property are not, in respect of it, contributing a reasonable, equitable, and full share towards the public revenues of the community, local and national".¹ There is, however, little in this argument, especially if the tax falls on surplus due to luck as in the scheme of Mr. Lloyd George in 1909. There is nothing unfair in imposing a special tax on an increase of wealth due not to good management or foresight but to a stroke of good fortune. Such a tax would not discourage production, and moreover, there is the necessity for the State to get revenue, and it is only fair that a part of the surplus should go to the State primarily in regard to urban sites. There can be to this proposal no objection in principle.

5. THE TAXATION OF CORPORATIONS

Another form of the taxation of surplus which is widely prevalent in the United States is the taxation of corporations. In many ways the taxation of corporations may be looked on as taxation of business, but it is preferable to regard it as a tax on corporation surplus. Many of these corporations, especially those of a monopolistic nature, show profits greater than are required to attract capital and to maintain production. Governments confer certain special privileges or a franchise on a corporation, and by this the corporation possesses certain advantages or privileges.² When as a result the earnings of the corporation are in excess of a reasonable return on the amount invested in the real estate, machinery, or other property, and when this excess is not attributable to any other cause except its corporate charter, it is only just that corporations should be taxed for the additional privileges they enjoy over individuals. All things considered, it has been

¹ Sir Thomas Whittaker, *Ownership, Tenure, and Taxation of Land*, p. 485. Macmillan & Co., London, 1914.

² For the taxation of corporations, see Seligman, *Essays in Taxation*, chapters vi.-viii., 9th edition, Macmillan, 1921.

considered advisable to classify the taxation of corporations under the taxation of surplus, although much may be said against this procedure. It is one largely of convenience. Henry C. Adams believes "the corporation tax and the monopoly problem are closely allied, and no satisfactory adjustment of corporate taxation can be expected except it be made under the influence of some general theory respecting the solution of the monopoly problem".¹ These corporations possess certain rights, such as the right to be a corporation, and thereby to use the corporation name, to sue and be sued as a corporation, and also the right to do or to act. Limited liability and juristic personality are some of the privileges which corporations enjoy. There is a third group of special privileges, which includes good-will and the right to use public streets for transit by tramway and other companies, etc. The tax may be levied on the net receipts, which constitute the best index of tax-paying ability. In America railways and other transportation companies are taxed by a special board. If the railways spread through, as they do, several States, relative mileage is usually taken as the basis of apportionment of the receipts. Banks, insurance companies, and land associations are also assessed, as are mining and other monopoly companies, together with public utility monopolies, such as electric lighting and gas. For State purposes a tax on earnings or on capital or loans received within the State may be taken as a guide, except for railways, for which relative mileage is a better test. No distinction should be made between domestic and foreign corporations. If the corporation is taxed on property, the property outside the State should be exempted. The main point which we are here concerned with is the question of obtaining a share of the surplus which results from the existence of the corporation. The modern tendency is to tax corporations on their income,² but Japan taxes them on their excess incomes. Opinion is not unanimous as to whether the corporation tax should be Commonwealth or Federal in the United States. Some authorities, such as Adams, hold it should be exclusively a source of State revenue, while others, like Seligman, think it should be Federal rather than local. He therefore proposes Federal administration with State apportionment of the tax.

¹ *The Science of Finance*, p. 453 (New York: Henry Holt & Co.).

² Chapter XXI.

In Great Britain there was a corporation tax from 1920, when the Finance Act of that year charged (1) all British companies carrying on any trade or business, and (2) foreign companies carrying on any trade or business in the United Kingdom so far as those profits arose in the United Kingdom. The tax was 5 per cent of the profits. Limited liability companies alone were liable to this tax, but many public utility companies and building societies were exempted. Public utility companies, like gas, water, electricity, tramway, hydraulic power, dock, canal, or railway undertakings, whose prices for services rendered or dividends distributed are limited by an Act of Parliament, were excluded from the scope of the Act. The chargeable profits included income from immovable property and investments, but excluded interest on loans and royalties paid to persons other than those having a controlling interest in the company. Interest on certain Government securities, profits of industrial and provident societies arising from trade with their own members, and societies for house-purchase for members were excluded from liability to the tax by the Finance Act of 1921. Interest on mortgages was allowed for while computing the profits of companies, half or more of whose gross income was derived from rents or profits of lands and tenements in the United Kingdom. The first £500 of the profits of companies was free from tax. Excess Profits Duty was deducted while computing profits for purposes of the Corporation Profits Duty. The number of assessments in 1920-1921 was 11,259, and 39,395 in 1921-22. The net receipts amounted to £701,777 in 1920-21 and £17,704,395 in 1921-22. This corporation duty was in addition to the income tax under Schedule D. The corporation profits tax has been abolished since 1st July 1924 in order to further the development of trade. The corporation profits tax should not be confused with the corporation duty imposed by the Customs and Inland Revenue Act of 1885 as a stamp duty by way of compensation to the revenue for the non-liability to death duties of certain property vested in bodies corporate or incorporate. The corporation duty was levied at the rate of 5 per cent on the net annual value, income, or profits accrued in respect of real or personal property vested in such bodies.¹ Corporation taxation exists also in Switzerland, Germany, and in Canada. In Manitoba there is a corporation

¹ Acts 48 & 49 Vict. c. 51.

taxation Act which provides for a tax on the head office and the branches of a bank, on insurance companies, and on trust companies. In Japan corporations are taxed only on their income, and this forms part of the system of income tax. The Federal Government in the United States taxes corporations by means of the general income tax only. The development of the taxation of corporations in the United States is of interest. Previous to the introduction of the general corporation tax, attempts were made to reach corporation incomes by the property tax with the assessment of real and personal property by local officials. When the defects of this system were recognised a special board was appointed to assess transportation companies, especially railways, and the basis of taxation was changed from property to volume of business, value of stocks and bonds, and other elements supposed to indicate taxable capacity in the case of banks, insurance companies, and public service corporations. Railways were taxed on many bases. There was general chaos in regard to this form of taxation. The chief methods followed were: (1) The property tax with local assessment, (2) the *ad valorem* system of valuing tangible property and privileges, (3) the taxing of both debentures, bonds or stocks or shares, and (4) the taxation of gross or net earnings. The basis of taxation of corporations may be grouped under the general headings property, volume of business, and earnings. For the assessment of property the original cost, the cost of reproduction, and the par or market value of stocks and bonds were suggested as a possible basis. But the original cost bears no relation to present value, the cost of reproduction includes many uncertain factors, the par value is only nominal, and the market value is a shifting basis, highly speculative, and very often it includes non-dividend-paying stocks or shares. The volume of business as a basis of taxation is in many respects a clumsy way of levying taxes. This includes a diversity of commodities and services, and although the business may be large, it may not be invariably lucrative. In the case of banks and insurance companies, however, the volume of business may represent an equitable basis of assessment. Gross earnings should not be the basis of taxation, as due allowance should be made for necessary current operating expenses. Net earnings constitute the ideal basis for taxation. Several ingenious methods have been devised for evaluating the franchise or privileges of corporations,

but these are more or less makeshifts, and will disappear with the advent of scientific methods of taxation. A general corporation tax based on capital or income now obtains in many of the States of the United States of America. This tax should not, of course, be confused with the tax on corporate charters, which is, in fact, a fee for the privilege of incorporation. Most of the local bodies tax corporations on the basis of their real estate. The Commonwealth or State Governments sometimes tax corporations both on property and debts, property and income, and property and stock, but, as these are not interchangeable terms, there is no unjust double taxation. If both corporations and holders of stocks and bonds were to be taxed, the question of double taxation would arise. The general procedure is to tax corporations and to exempt the individual on his income from corporate investments. Some States tax all corporations without exception, while others limit the tax to certain kinds of corporations only. In the latter there is scope for the amortisation of the tax, but in the former the tax cannot be discounted.

6. EXCESS PROFITS TAXATION

The third main class of taxation of surplus is the excess profits duty, which is charged on profits of trading concerns and not on individuals. In the late War very great demands were made on certain businesses, especially those engaged in the manufacture of munitions, and profits were made by firms which were able to take advantage of these exceptional circumstances. Such profits were far above the pre-War level and far higher than what were required to maintain output. The amount of tax was determined not by the total profits but by the profits in excess of a certain standard. In short, the taxation of this was a tax on profits in excess of a prescribed return on capital.

In 1863, during the American Civil War, the State of Georgia levied a tax from 5 to 25 per cent on profits in excess of 8 per cent on capital stock. In the early part of 1915, when Germany was importing food supplies from Scandinavia, the tax was introduced there, and shortly afterwards in Great Britain, first as a munitions levy and subsequently as an excess profits duty. Seldom has the fashion of imitation been so evident in taxation, for in less than two years, *i.e.* in 1917, more than a dozen countries adopted this

system of taxation. The two main problems which confronted all countries were (1) the determination of normal rates of profits beyond which the surplus was liable to a special tax ; and (2) the method of taxing this excess. The excess profits duty proper, as in Great Britain, was purely a temporary measure and was discontinued in 1921. If the tax is purely a temporary measure, it is possible to take the profits of a particular period as the standard. If, on the other hand, the tax is to continue for a period as part of the general tax system, it is better to fix the minimum percentage above which all profits will be taxed. In, for example, the United States (which followed Canada's plan) pre-War profits were disregarded. A tax on the net income of partnerships and corporations in excess of 8 per cent of the actual capital invested was imposed. To this we shall again refer.

In order not to affect detrimentally production, the normal rate of profits should not be pitched at too low a level. Evasion and wasteful production may take place unless the rate of duty is kept low. It is said that excess profits duties stimulate extravagant expenditure on account of the fact that allowances are made for expenditure. This has sometimes been taken as a reason which counteracts the splendid productivity of such forms of taxation. Other criticisms of the tax were (1) that it was limited to a small number of business concerns and therefore was unequal ; (2) the tax was said to be complex ; (3) it was also alleged to be uncertain ; (4) that it pressed more heavily on such industries as construction, manufacturing, and mining than it did on companies with more stable earnings such as banks ; and (5) that the tax was passed on with additions to the consumers. These reasons have only to be stated in order to show their invalidity. Provided the tax is not pitched at too high a level, and has normal exemptions and reliefs with efficient administration, this form of taxation of surplus is undoubtedly good. Had there been a duty or not, full monopoly prices would have been imposed, and it was only when the duty gave an opportunity for charging more by the threat of checking supply that it raised prices directly.

The taxation of surplus in this form in Great Britain was first done, as already noted, under the Munitions Levy, or more correctly the Munitions Exchequer Payments. The Munitions Levy was imposed on controlled establishments as a bargain between labour, capital, and the State for the production of war materials.

Labour accepted certain conditions prejudicial to its interests for the sake of increased production, and capital in its turn agreed to hand over to the State its profits in excess of the average of the two pre-War years plus one-fifth of the same profits. This levy was restricted to certain controlled concerns only, but these were liable to the excess profits duty subsequently imposed or the Munitions Levy, whichever was higher. The Munitions Levy ceased with 31st December 1916. The excess profits duty was imposed by the Finance Act of 1915 with the definite object of raising revenue, and unlike the Munitions Levy affected all trades and businesses, including agency, carried on inside or outside the country by those persons who were resident in the United Kingdom. Agriculture, offices, or employments, professions and commercial travellers were exempted from the scope of the tax. The normal standard was based on the average profits of the business in the best two out of the last three pre-War years. Where there had been only two years of pre-War trading, the standard was the average profits of those two years. Where there had been only one year of pre-War trading, the standard was of that year. If there were no pre-War years a percentage upon the capital employed was taken. Assets were valued at cost after allowing for wear and tear, investments outside the business were excluded, and debentures and other loan capital were deducted as liabilities from the assets. After the 31st December 1919, £500 was added to the percentage standard for each proprietor working full time in the business. The percentage rates for companies and other corporate bodies were 6 up to the 31st December 1916, and after that date in the case of business having one or more pre-War years 6 per cent. In the case of a business having less than one pre-War year, or a business commenced since the War, 9 per cent increased by 2 per cent for accounting periods after 31st March 1919 was fixed. In the case of private companies these were 7, 8, and 11 per cent, in the last case increased by 2 per cent for accounting periods after 31st December 1919. Special percentage rates were granted, not to individuals but to trades as a whole, by a Board of Referees specially appointed by the Treasury. The differentiation between private firms and corporate bodies was made in order to equalise the incidence of the duty. Remuneration paid to the directors and managers of corporations was deducted from profits, but no deduction on

account of remuneration to proprietors or partners was allowed in private businesses. Certain classes of trade to which special risk attached were given an increased percentage rate, and the profits of companies were computed on the same principle as for income tax purposes, with certain exceptions. Income derived from investments (except in the exceptional case of investment concerns) was excluded from the computation of profits. The exceptions were (1) a deduction on account of interest on borrowed money, (2) the restriction of the remuneration of directors and managers to the amount paid in the pre-War year unless the Commissioners of Inland Revenue decided otherwise, (3) allowances in respect of depreciation and postponement of repairs due to the War, and (4) adjustments according to the variation of capital in the pre-War years and in the subsequent accounting period. A statutory allowance of £200 for every business, subject to a maximum of £800 for small businesses, was made before fixing the excess profits. Profits below the standard in any one accounting period could also be set off against the excess profits in another. This right was denied to the successors of the business owners, but the Finance Act of 1922 extended the privilege to cases where the successor was the husband, wife, ancestor, or lineal descendant of the previous owner of the business. The rate of duty was as high as 80 per cent from 1st January 1917 to 31st December 1918. It was never lower than 40 per cent, the rate during 1919. When the duty was discontinued from 1921 it was arranged to allow relief in respect of a heavy drop in the values of traders' stocks. In no case was liability for duty to continue after the 4th August of that year. The Finance Act of 1922 provided that the payment of the outstanding arrears of excess profits duty might be spread over five years of quarterly instalments with simple interest at $4\frac{1}{2}$ per cent per annum. The duty was collected by the Commissioners of Inland Revenue, and payment was made two months after the notice of assessment, although the Commissioners were empowered to accept payment by instalments in suitable cases. Discounts at varying rates were allowed on pre-payment, and certain Government securities issued during the War were accepted in satisfaction of the duty. Although the administration of the Act was centralised in the Commissioners of Income Tax, the main work was entrusted to H.M. Inspectors of Taxes. Certain rights of appeal were permitted to the General

Commissioners of Income Tax and to the Special Commissioners of Income Tax, and on points of law either party might appeal to the courts of law on certain specific points of dispute. There was a Board of Referees appointed by the Treasury, from whom also there was an appeal on points of law to the courts.

The Excess Mineral Rights Duty was complementary to the Excess Profits Duty, and was levied at the same rate. The owners of mineral royalties were taxed on the excess over the royalty paid in the pre-War years. The duty was only imposed in those cases where the rate of mineral royalty varied according to the selling price of the minerals.

In New Zealand the excess profits tax was brought into operation in 1916. This was found inequitable and otherwise unsatisfactory, and a system of progressive land taxation, together with a higher income tax and a new special War tax on incomes over a fixed amount, was adopted in 1917. The War Time Profits Tax of Australia came into force on 22nd September 1917, and ceased to exist on 1st July 1919. The standard for calculating the excess profits was taken to be either the average profits of two of the three years before 4th August 1917, or 10 per cent of the capital employed in a business. The year of assessment was the War-time financial year 1st July to 30th June. For 1915-16 the rate of tax was 50 per cent, and for subsequent years 75 per cent. Legislation based on similar principles was enacted in the other Dominions, but was temporary only.

In India, under the Act of 1919, income from agriculture, offices, or employments and professions mainly dependent on personal qualifications were exempt from liability to excess profits duty, as also any business paying similar duty in the United Kingdom or of which the profits did not exceed thirty thousand rupees. The duty leviable was 50 per cent of the amount by which the profits in the accounting period exceeded the standard profits which were ordinarily calculated at the rate of 10 per cent of the capital of the business. The assessee, however, could exercise the option of calculating the standard profits according to certain prescribed methods. The collector was entrusted with the power of making allowances for special circumstances caused by a change in the constitution of the partnership, postponement of renewals, and repairs owing to the War, exceptional depreciation, etc. The amount charged as excess profits duty was

deducted from profits before assessing income tax as in Great Britain. Excess profits duty was not levied if super tax was charged. The higher of the two taxes alone was chargeable.

In the United States the excess profits tax was confined at first to profits directly traceable to war, but it was later on extended to all concerns.¹ The tax, as has been noted, was levied on profits in excess of 8 per cent of the actual capital, with an exemption of \$6000 for individuals and partnerships and \$3000 for corporations. Profits below 20 per cent, but above this minimum of the invested capital, were taxed at 20 per cent, and those in excess of 20 per cent at 40 per cent. The tax extended to all trades and businesses, including professions and occupations, but beginning with 1918 the tax was only confined to corporations, excluding personal-service corporations (*i.e.* those whose income is to be ascribed primarily to the activities of the personal owners or stock-holders who are themselves regularly engaged in the active conduct of the affairs of the corporation, and in which capital, whether invested or borrowed, is not a material income-producing factor), which were taxed substantially as partnerships. The object of this was that, as the American income tax falls more lightly on corporations than upon other taxpayers, the tax should fall equally. Under the income tax the entire income or profit of an individual is subject to normal tax and surtaxes, which extend to as high as 50 per cent whether the income is spent or reinvested, but the corporation does not pay income surtaxes, and its stock-holders only pay surtaxes on the profits which are distributed. It was repealed in 1921, as, according to the Secretary to the Treasury, it encouraged wasteful expenditure, put a premium on over-capitalisation and a penalty on energy and enterprise, and it confirmed old undertakings in their monopolies. The duty as levied in the United States was indeed open to these criticisms. In Japan the taxation of excess incomes forms part of the income tax system. When the income of a corporation for any business year exceeds 10 per cent of the average amount of paid-up capital and reserves, that part of income exceeding 10 per cent is taxed at 4 per cent, 20 per cent at 10 per cent, and 30 per cent at 20 per cent.

¹ Excess Profits Tax (Act of 3rd March 1917); War Excess Profits Tax (Act of 3rd October 1917); War Profits and Excess Profits Tax Act (Act of 24th February 1919).

In itself, the excess profits tax is a good tax, and when again levied should obviate, as far as possible, the weak points of the American Act, especially in respect of (1) a fixed percentage of profits (which should not be calculated on subscribed but on paid-up capital) ; (2) the allowances on account of expenditure without efficient check ; and (3) the same allowance of normal profits for old and new ventures.

In the subsequent chapters we shall deal with indirect taxation.

CHAPTER XXV

INDIRECT TAXATION—GENERAL PRINCIPLES

INDIRECT *VERSUS* DIRECT TAXATION

1. FROM direct taxation we turn to indirect taxation. Here we are faced with the old controversy between direct and indirect taxation. "I never can think", said a great Scotsman,¹ "of direct and indirect taxation except as I should think of two attractive sisters who have been introduced into the gay world of London, each with an ample fortune, both having the same parentage—for the parents of both I believe to be Necessity and Invention—differing only as sisters may differ, as where one is of lighter and another of darker complexion, or where there is some variety of manner, the one being more free and open, and the other somewhat more shy, retiring, and insinuating. I cannot conceive any reason why there should be any unfriendly rivalry between the admirers of these two damsels; and I frankly own, whether it be due to a lax sense of moral obligation or not, that as a Chancellor of the Exchequer, if not as a Member of this House, I have always thought it not only allowable but even an act of duty to pay my addresses to them both. I am therefore as between direct and indirect taxation perfectly impartial. But then I must say, that with regard to the remission of indirect taxes, I hope that the memorable history of the last twenty years² will never be forgotten; for I do not scruple to state that if you look to its economical profits on the one hand, and then to its political, social, and moral results on the other, it is difficult to know which to give the palm in point of magnitude. If we had

¹ Gladstone, Financial Statement, 1861, Hansard, vol. clxii. p. 584.

² When the number of indirect taxes was greatly reduced (see below).

not gained one single shilling by the remission of indirect taxation it would have been worth having for the sake of the manner in which it has knit together the interests and feelings of all classes of the community from one end of the country to the other. If, on the other hand, it had had nothing to do with any question of moral and social results, still the merely economical results in promoting the material well-being of the people have been so signal and extraordinary that we may well rejoice to have lived in a period during which it has been our happy lot to take part in bringing about such changes. But, Sir, there cannot be a grosser delusion than the supposition that the work of Parliament, during the period I have named, has been to destroy indirect taxation. The hand of Parliament has wrought a pruning—not to destroy the tree but to strengthen the stock. The aim of the operation has been to give it greater size and vigour ; and the consequence is that at this moment, when indirect taxation has been destroyed as the fashionable phrase is, not once but four or five times over, indirect taxation is larger and more productive—I do not mean in this particular year, but in any ordinary year, and upon the average of the last two or three years—than at any former period of our history. Its condition recalls to my mind the tree of golden leaves which has been described by Virgil, from which his hero was ordered to pluck a branch, and on whose trunk, the moment one branch had been plucked, another took its place.”

THE IMPORTANCE OF INDIRECT TAXATION

2. Indirect taxes have already been defined,¹ and we have seen that while indirect taxes are normally collected from the home manufacturer, as for instance in the case of excise duties, or from the importer or exporter as in customs duties, they are shifted on to the shoulders of the consumer in the shape of higher prices for the goods consumed. Since much direct taxation flies over the heads of wage-earners, Governments in all countries have had to depend on indirect taxes for a large part of their revenue. The direct taxation of wages is usually prohibitive on account of the cost of collection, and wages contain a taxable element. The amount for which a labourer offers his services and the amount

¹ *Vide* Chapter XVIII.

on which he and his family can subsist are two entirely different things. With the development of direct taxation in the present century, especially since the Great War, the proportion of revenue raised from indirect taxes in some countries has decreased. This

I. UNITED KINGDOM				
	20 Years ago.	10 Years ago.	Pre-War Year.	Now.
	(1901-2.)	(1911-12.)	(1913-14.)	(1921-22.)
<i>Direct Taxation—</i>				
Income tax	28·5	28·9	28·9	46·6
Other direct taxes . .	13·7	18·6	18·9	13·2
Total	42·2	47·5	47·8	59·8
<i>Indirect Taxation—</i>				
Excise *	25·7	21·1	21·8	22·2
Customs	25·4	21·7	20·8	15·8
Others	6·7	9·7	9·6	2·2
Total	57·8	52·5	52·2	40·2
Total tax revenue . .	100	100	100	100
II. INDIA				
<i>Direct Taxation—</i>				
Income tax	3·1	3·2	3·8	18·6
Other direct taxes . .	45·7	41·9	43·1	26·4
Total	48·8	45·1	46·9	45·0
<i>Indirect Taxation—</i>				
Excise (including salt) .	34·0	32·5	27·1	21·8
Customs	8·9	12·4	14·7	26·1
Others	8·5	10·0	11·3	7·1
Total	51·4	54·9	53·1	55·0
Total tax revenue . .	100	100	100	100

* Indirect excise only.

is noticeably so in Great Britain and in the Federal revenues of the United States. Indirect taxes before the War were 52·2 per cent of the total tax revenue in the former and 89 per cent in the latter. To-day the percentages are 40·2 per cent and 30·6 per cent.¹ In other countries, while direct taxation has developed,

¹ *I.e.* for 1921-22. For detailed figures see Table XII. App.

indirect taxation has increased even in greater proportion. This is due mainly to higher taxation in excise and to the spread of protection in import duties. In India before the War indirect taxation was 53·1 per cent of the total tax revenue ; to-day it is 55 per cent, owing to a large increase in customs duties and in excise duties.¹ The preceding tables show the distribution of indirect taxation in the United Kingdom and India.

It will be seen that in India for the most recent year 45·0 per cent of tax revenue was from direct taxation and 55·0 per cent from indirect taxation. In Great Britain the corresponding figures were 59·8 per cent and 40·2 per cent. If indirect taxation be divided into (a) that derived from necessities,² and (b) luxuries or sumptuary articles, the 55·0 per cent for India under indirect taxation would show that 9·9 per cent came from taxes on luxury, and 45·1 per cent from necessities. In Great Britain the figures are 6·7 per cent and 33·5 per cent. There was no rule that there should be 50 per cent direct taxation and 50 per cent indirect. Attention must be given to local circumstances, especially the ability to pay taxation. The reduction, for example, of indirect taxation often gave more spending power to the generality of the population, and this might lead to investment of money or capital as if the reduction was made in direct taxation. If the reduction was spent in increased spending power it meant, *ceteris paribus*, more trade.

As compared with the pre-War year, indirect taxation is now of less importance on account of the development of direct taxation in the following countries : ³

Great Britain.

Australia.

Canada.

New Zealand.

France.

U.S.A.

Japan.

¹ See Table XXIV. App.

² Only tea, coffee, sugar, and salt have been included.

³ See Table XXIV. App.

THE CASE FOR INDIRECT TAXATION

3. To the financier indirect taxes are invariably tempting. By these he can reach the poorer classes on whom it is difficult, if not altogether impossible, to levy direct taxes. That is one great argument in favour of indirect taxes. In the second place, many indirect taxes have great financial virtues: they are productive, and to the Finance Minister, who has to get revenue with as little fuss as possible, that is of first importance. They are also convenient and less irritating than direct taxes. Thus a large revenue can be raised with little protest. This sometimes tends to promote extravagance. Thirdly, it is expedient to have balance between direct and indirect taxation. Indirect taxation, therefore, prevents exclusive concentration on the important direct taxes and preserves the golden rule that the collection of a State's revenue should be on as broad a basis as possible. Too heavy taxation, direct or indirect, at any point or points will tend to evasion, and to the interference with and the crippling of industry. When Sir Robert Peel abolished over 600 customs duties and reduced over 1000, the decrease in the annual customs revenue of the United Kingdom was in the long run comparatively small. The taxation of raw materials and of goods that aided production was gradually done away with, as these were hard to collect and expensive in their effects on the consumer, who has to pay in addition to price for the tax and the interest on the tax advanced by the producer. An excise on iron and steel would raise the price of one of the essential articles of production, and should for revenue purposes be avoided in favour of articles ready for direct consumption. In short, the greater the complexity of indirect taxation, the greater the evasion, and the greater the tendency to a large part of the yield being swallowed up in the cost of collection. Direct taxes are on the whole cheaper to collect than indirect taxes.¹ The cost of collection of income tax is especially low. Thus in India it was 1·2 per cent of the receipts in 1921-22, while indirect taxes were more expensive to collect. Customs in the same year formed 1·8 per cent and excise 7·1 per cent. The cost of collection of customs in the United States was 3·04 per cent as against 1·03 per cent for internal revenue, 70 per cent of which was direct taxation in the year ended 30th June 1922.

¹ Sect. 10, Chapter XXII.

INDIRECT TAXES REGRESSIVE

4. In a workman's family budget the expenditure on articles indirectly taxed, such as tea, sugar, salt, and spirits, is relatively greater than in the family budgets of the well-to-do. No allowance is of course made, as in the case of direct taxation, for family responsibility. The head of a family has to pay more than the bachelor and no differentiation can be made between earned and investment income. Indirect taxation is regressive in character, and ordinarily falls more heavily on the poor than on the rich, because the poor are the largest consumers. The burden then varies inversely with ability. If a specific duty is levied, say at so much per lb. regardless of quality, there may be double differentiation against the poor. Thus a tax of eightpence on each pound of imported tea would be $33\frac{1}{3}$ per cent on tea valued at two shillings, and only $13\frac{1}{3}$ per cent on tea valued at five shillings. In such cases indirect taxation is doubly regressive.

THE IMPOSITION OF INDIRECT TAXES

5. The general rules governing the imposition of indirect taxes are as follows: The taxes should be laid on articles which are largely consumed and for which the demand is inelastic, *i.e.* an increase in the tax should not curtail to any large extent consumption. The tax, moreover, should be easily collected. The production of the goods should not be scattered in the hands of small producers, as the administration of the tax would then be too difficult and too burdensome. If these conditions obtain, the net yield of the tax should be great. During the Napoleonic Wars, and before Huskisson's views gained general support in England, these simple canons were frequently forgotten. It is true that the number of commodities capable of satisfying all these conditions, or even two of them, is not large. In most countries they are confined to such articles as tea, sugar, tobacco, spirits, wines, salt, and, as in Germany before the War, on food-grains imported. The articles taxed will vary from country to country according to the consumption of the inhabitants of the country. Otherwise the productivity of these taxes would suffer and the State would not get the maximum revenue with the minimum effort. During the War,

attempts were made to tax all kinds of luxuries, but it was found extremely difficult to define luxuries. Clothing, shoes, etc., become articles of luxury when bought by the individual for his own use in large numbers. When the expensive grades of goods were taxed, it forced consumers to buy the cheaper ones. Cost of collection and evasion had also to be considered. In France luxury taxation has not been successful, and the turnover tax¹ on all expenditure, whether on necessary or unnecessary articles, has taken its place. The main criticism of the taxation of necessities, including conventional necessities, is that the burden falls more heavily on the poor than on the rich, just as taxes on luxuries press heavily on the rich. If the taxation of necessities is extended too far the poorer classes will suffer, and it is for this reason that Labour Governments favour direct rather than indirect taxation. The first Labour Government in Great Britain reduced in its first Budget (1924) indirect taxes, including all the food duties, especially those on tea, coffee, chicory, sugar, dried fruits, sweetened table waters, and abolished others, such as the inhabited house duty, while leaving the main direct taxes—income tax and death duties—as they were. The Corporation Profits Duty was, however, repealed.

SUMMARY

6. All things considered, indirect taxes are good taxes in tax systems when they are productive, convenient, and approximately equitable. They are paid with less irritation than direct taxes. Revenue can be raised in multifarious ways by indirect taxation, and the basis of taxation is thus broadened, the concentration on the main direct taxes becoming unnecessary. As already noted, the taxation of necessities may be quite justified, especially in less wealthy countries. Their exemption should only be permitted if other objects equally good from the point of view of productivity and convenience are available. The policy underlying this taxation must vary with the conditions of each country. Italy's salt monopoly is undoubtedly taxation, and her octrois on food, etc., even for State purposes, are on necessities. Similarly, the taxation of sugar, salt, and matches in France is of this category.

¹ See below, Chapter XXVII. sect. 4.

CHAPTER XXVI

CUSTOMS DUTIES

1. GENERAL ECONOMIC CONSIDERATIONS

SEA and land customs duties are earlier in origin than excise duties. In Adam Smith's words, "The duties of customs are much more ancient. They seem to have been called customs, as denoting customary payments which had been in use from time immemorial. They appear to have been originally considered as taxes upon the profits of merchants."¹ In the Roman Empire we read of customs duties in the provinces which usually did not exceed 5 per cent *ad valorem*. In mediaeval Europe we find export duties and later import duties as a source of revenue. For a long time special customs were levied on goods passing between England and Scotland. The transit duty may, in fact, be regarded as it is to-day between British India and Native States as a customs duty. The ruling prince or chief charges duties on goods passing into his state, not merely for services rendered, such as protecting the goods of the importer or exporter, but as a source of indirect taxation.

In Anglo-Saxon England we know that the king made a levy on goods through his sheriffs for the maintenance of the Royal Household, and he probably had some revenue from foreign trade. The merchant, speaking of the dignity of his profession, mentions that he is "useful to the king and his nobles, to rich men and to common folk". In later years, subsequent to the Norman period, the king fixed duties on the export of wool fells (*i.e.* skins with the wool on them) and on leather. In the Magna Charta these were called "the ancient

¹ Book V. chap. ii. part ii. art. iv.

and equitable duties " as compared with those on wine known as " the new customs ". Tonnage and poundage were levied from the time of Edward I. (1302) for life, and were fixed at 3d. on every pound of merchandise and 2s. on every tun of wine imported, also at various rates on exports. Customs subsidies were granted for short periods in addition to the hereditary duties, and the life grant of tonnage and poundage. We shall see below how these duties were levied to promote, especially in the eighteenth century, home manufactures.

Export duties were levied, as it was frequently thought that the foreigner would pay the tax. They were sometimes imposed in order to prevent exports. Owing to the teaching of the mercantilists, export duties became less popular, as such duties were held to restrict exports. To-day export duties are no longer so popular. It is held that the exporter competing in foreign markets may find himself handicapped by the taxation of exports, and that if he is to continue exporting the taxed products he will have to pay the tax. If, however, as in India with raw jute and lac, and in Brazil with coffee, and Chile with nitrates, the taxing country has a monopoly or quasi-monopoly, and the demand is inelastic, the consumers abroad will ordinarily pay the tax. Speaking generally, however, export duties are unpopular, as they tend to handicap the home producer, and owing to the rise in prices they may curtail output, while in the long period they may lead to the development of other sources of supply or the use of substitutes. The main principle, then, is that the home producer should not be penalised by an export duty, except when there is reasonable probability that the tax will fall mainly, if not entirely, on the foreigner, and when there is no apparent likelihood that the production of the commodity in the country exporting the article will be affected. Export duties for revenue purposes should, in short, be sparingly used, and imposed to a moderate degree only on those articles in which the taxing country possesses a monopoly or quasi-monopoly.¹

For the converse reason import duties are increasingly popular. The advantage to home industry, coupled with the convenience and productiveness of the tax, tends to make import duties more and more prominent in customs systems. A tax on imports, as

¹ For incidence of export duties see Chapter XVIII. p. 194.

we have already seen in discussing the incidence of import duties,¹ may fall on the consumers in the taxing country when the foreign producer has alternative markets. If the taxing country is the only market, and if the demand for the article is elastic, the producer may be forced to bear the tax in order to preserve his business with the taxing country, but the supply will, other things being equal, be curtailed until prices recover, except, of course, if monopoly prices have hitherto been made.²

There are other economic considerations to be taken into account in discussing customs duties. It is not possible to gain a large revenue from customs duties and at the same time to have protection. An import duty, if it is to be protective, cannot produce revenue. Similarly, taxes on dumped articles can never be relied on to produce revenue. As Adam Smith said, "Taxes proposed with a view to prevent, or even to diminish, importation are evidently as destructive of the revenue of the customs as of the freedom of trade".³ Some countries, notably the United States, have attempted, not very successfully, to combine high protective duties with revenue duties. Protective duties have been placed on industries to be protected, such as the textile, iron, and steel industries, and revenue duties on tea, coffee, sugar, and tobacco. If the important consideration is revenue, it is necessary that the commodities to be selected for taxation should be those which are consumed in sufficient quantities to produce the required revenue. In other words, articles which satisfy the ordinary demands of life for the bulk of the population must be placed on the tariff lists. These articles will vary in the case of each country. It is not possible, as suggested by J. S. Mill, to levy customs duties only on articles which are not produced in the country. The question of productiveness and economy, always to the fore with the financier, must receive preference. It is also at times unavoidable to tax raw materials. Taxes on raw silk, for example, may have the effect of taxing the consumers of silk goods. It will thus be possible to tax in a non-vexatious way the particular class of consumers who wear silk goods.

If the aim is to protect home industries, other points have to

¹ *Vide* Chapter XVIII.

² For incidence of import duties see Chapter XVIII. p. 192.

³ *Wealth of Nations*, Book IV. chap. ii.

be considered. Suppose it is necessary to protect wool and to encourage woollen manufactures. It would be then advantageous to add to the duty upon imported manufactured woollens a compensatory rate, *i.e.* a rate which should compensate home manufacturers for the rate already imposed upon the raw material imported. A protective duty is sometimes the best method for the experiment of a young and rising industry. "The nation", said List, "must sacrifice and give up a measure of material prosperity in order to gain culture, skill, and powers of united production; it must sacrifice some present advantages in order to ensure to itself future ones."¹ "A sufficient period of incubation must be allowed for in order to give capitalists confidence in the future profitableness of the business. In framing tariff lists, however, the doctrine of comparative costs, *i.e.* the relative cost of producing different goods in the home country, has to be considered, and industries have to be selected mainly on this basis."² An import duty of a protective kind usually acts as a bonus or impetus to a home industry. At first it will lead to an increase in price in the country itself, but this may in the long run lead to a lower price as the industry becomes developed. A country may, as it is hoped in the case of India's steel production, have such special facilities in the way of raw materials as to lead to large scale production of a key industry, such production having hitherto been prevented by the lower price of the imported article. It is necessary to protect infant industries from unfair foreign competition and to keep out the dumped article. Protection, too, may result in larger economies through production on a large scale.

Public opinion deprecates any disposition on the part of a free-trade country, such as Great Britain, to suggest to the Dominions and India, or to a great and friendly republic, like the United States, what its fiscal policy should be. That is a matter of purely domestic concern. Indeed the Joint Select Committee on the Government of India Bill recommended that "nothing is more likely to endanger the good relations between India and Great Britain than a belief that India's fiscal policy is dictated from Whitehall in the interests of the trade of Great Britain.

¹ *The National System of Political Economy*, p. 117 (Longmans, Green & Co., 1916).

² Cairnes, *Some Leading Principles of Political Economy*, part iii. chap. ii.

That such a belief exists at the moment there can be no doubt. That there ought to be no room for it in the future is equally clear. India's position in the Imperial Conference opened the door to negotiation between India and the rest of the Empire, but negotiation without power to legislate is likely to remain ineffective. A satisfactory solution of the question can only be guaranteed by the grant of liberty to the Government of India to devise those tariff arrangements which seem best fitted to India's needs as an integral portion of the British Empire. It cannot be guaranteed by statute without limiting the ultimate power of Parliament to control the administration of India, and without limiting the power of veto which rests in the Crown ; and neither of these limitations finds a place in any of the statutes in the British Empire. It can only, therefore, be assured by an acknowledgement of a convention. Whatever be the right fiscal policy for India, for the needs of her consumers, as well as for her manufacturers, it is quite clear that she should have the same liberty to consider her interests as Great Britain, Australia, New Zealand, Canada, and South Africa. In the opinion of the Committee, therefore, the Secretary of State should as far as possible avoid interference on this subject when the Government of India and its Legislature are in agreement, and they think that his intervention, when it does take place, should be limited to safeguarding the international obligations of the Empire or any fiscal arrangements within the Empire to which His Majesty's Government is a party." ¹

2. THE IMPORTANCE OF CUSTOMS REVENUE

In the chief industrial countries the customs revenue is, with rare exceptions, of relatively less importance in the total tax revenue than before the War. This is especially so in the United States and in Australia, where the development of direct taxation has accounted for a part of this decrease. India is one of the few countries which has considerably increased the proportion of revenue since the War, owing to a rise in duties and the spread of the idea of protection to her industries. The following table

¹ Report on the Government of India Bill from the Joint Select Committee, clause 33, p. 10 (Government Printing, Delhi, 1919).

shows the relative importance of customs before and since the War.

Country.	Percentage of Customs Revenue to Total Tax Revenue.	
	Pre-War.	Post-War.
Great Britain	21·8	15·8
India	14·7	26·1
Australia (Commonwealth)	76·3	34·9
Canada (Dominion)	81·2	63·1
New Zealand	57·9	31·1
S. Africa (Union) . . . . .	..	32·4
U.S.A. (Federal)	43·6	10·0
France	15·9	10·1
Italy	13·6	9·3
Japan	10·0	4·7

The greater proportion of customs duties is collected from a few articles. In the United Kingdom 90 per cent is collected from four articles, viz. tobacco, sugar, tea, and spirits. One of the many practical results of the publication of the *Wealth of Nations* was the reduction of the number of dutiable articles by Huskisson, Peel, and Gladstone in the nineteenth century, when the revenue-yielding tariff was relieved of the incubus of a large number of taxed articles. In India to-day 58 per cent of the total customs is collected from four articles, and the same may be said of certain other countries, such as the Dominions.

3. THE FORM OF A TARIFF

There is next the question of *ad valorem* and specific duties. An *ad valorem* duty is a duty expressed as a percentage of the value of the commodity, while specific duties are duties expressed as a definite sum to be paid for a definite measure or weight of the commodity. India, Canada, the United States, and Australia have mainly *ad valorem* customs duties, although in varying degrees. *Ad valorem* duties have been abandoned in Germany and in some other countries and specific duties have generally taken their place. The *ad valorem* duty in the United States depends, as in many other countries, on the declaration to be countersigned by the Consul in the exporting country. During

the War experience showed that even under efficient supervision, it is not infrequently impossible to get the actual market value of the goods at the time of exportation. In India forged documents were sometimes presented. But in India the system has worked better than in most countries, since *ad valorem* values as provided for under the Sea Customs Act are based on wholesale market prices.¹ The system, nevertheless, does undoubtedly lay a considerable amount of responsibility on the customs staff, but it provides for an automatic increase in revenue with the rise in prices, just as a specific duty provides against a fall in revenue when prices fall. It is also well known that it is more desirable that revenue should increase automatically than that the Government revenue should be maintained unaltered when a fall in prices occurs. Although the tariff in India is an *ad valorem* tariff, certain articles, such as salt, kerosene oil, spirits, and matches, are subject to specific duties, while other articles, mainly sugar, metals, silk, chemicals, and dyes, are assessed by means of the system known as tariff valuation, *i.e.* a combination of specific and *ad valorem* duties. The Government from time to time determine the value of the article under this tariff valuation system for purposes of assessment, and this value is then taken as the conventional value for the article in regard to the payment of customs duty throughout the period, usually a year. This tariff valuation system is equivalent to a system of specific duties adjusted from time to time to meet changes in prices, the basis being a uniform *ad valorem* rate. This system combines the advantages of specific and *ad valorem* duties. It has the

¹ Sections 30 and 31 of Act VIII. of 1878, which read as follows :

" 30. For the purposes of this Act the real value shall be deemed to be—

" (a) the wholesale cash price, less trade discount, for which goods of the like kind and quality are sold, or are capable of being sold, at the time and place of importation or exportation, as the case may be, without any abatement of deduction whatever, except (in the case of goods imported) of the amount of the duties payable on the importation thereof, or

" (b) where such price is not ascertainable, the cost at which goods of the like kind and quality could be delivered at such place, without any abatement or deduction except as aforesaid.

" 31. Goods chargeable with duty upon the value thereof, but for which a specific value is not fixed by law for the purpose of levying duties thereon, shall, without unnecessary delay, be examined by an Officer of Customs. If it appears that the real value of such goods is correctly stated in the bill-of-entry or shipping-bill, the goods shall be assessed in accordance therewith."

advantage of specific duties in that it relieves customs officials from often a difficult valuation, as in the case of the imports of manufactured silk, which is difficult to appraise. The importer also is able to calculate ahead what he has to pay as duty. If the adjustments are made at fairly frequent intervals the fluctuations in prices do not result in a loss of duty, and the public know under this tariff valuation system the exact rate at which duty is to be levied when doing their business. If the tariff of a country is high, specific duties are on the whole preferable from the administrative point of view. In the case of a specific duty the importer knows exactly what he will have to pay as duty, as in the case of tariff valuation. Specific duties, however, being fixed, require frequent changes when prices fluctuate, and they do not give a very clear idea of the rate of duty and the actual burden except to those with expert knowledge. On the whole, the system of specific duties and tariff valuations are preferable to *ad valorem* duties. In those countries where high protection is intended *ad valorem* duties require the most careful watching. The Indian Fiscal Commission, for example, concluded that "while the Indian tariff must contain, as at present, *ad valorem* and specific duties and tariff valuations, the system of specific duties and tariff valuations might be extended cautiously, wherever examination by the Tariff Board shows that this is likely to be in the general interests".¹

4. MISCELLANEOUS FUNCTIONS

The duties of the customs authorities are not confined to *ad valorem* and specific duties. They have to prevent the importation of certain articles. In Great Britain, for example, obscene literature, advertisements of lotteries, foreign gold and silver plate without assay, foreign reprints of copyright works, the plumage of birds (with certain exceptions), shaving brushes manufactured in or exported from Japan, and prepared opium are not allowed to be imported. In addition to the prevention of importation the customs authorities have to prevent the irregular importation or irregular exportation of certain goods. In Great Britain, explosives, synthetic organic dyestuffs, hops, arms and

¹ Report of the Indian Fiscal Commission, p. 150 (Simla, Superintendent, Government Central Press, 1922).

ammunition, dangerous drugs, and goods coming within the Anthrax Prevention Act, are imported under certain regulations and this requires careful scrutiny. Arms and ammunition, dangerous drugs, gold and silver coins, and gold bullion are similarly allowed to be exported under certain conditions only. The customs authorities, however, have other duties to perform, such as the preparation of statistics. In the United Kingdom the Customs and Excise Departments now form one Department, and these authorities undertake the collection, in certain cases, of income tax and the sale of stamps, the collection of agricultural statistics, the enforcement of certain health regulations, the detention of vessels and cargoes, the enrolment and payment of men for the Royal Naval Reserve, the investigation of claims to exemption from National Health Insurance, the collection of passenger returns under the Aliens Acts, the collection of the transferred taxes, and the administration of the Old Age Pensions Acts on behalf of the Government of Northern Ireland by virtue of an agency agreement under the Government of Ireland Act, 1920. Under the Safeguarding of Industries Act of 1921 the customs authorities have in Great Britain to levy a duty at the rate of one-third of the value of goods imported which are classified as key industry goods, but goods produced and manufactured in the British Empire are exempt from the special duty. Under the same act a similar rate of duty is levied on the importation of goods shown in the tariff list under the heading depreciated currency duty, provided these are manufactured in Germany. There are also preferential custom rates on certain goods which are, in many cases, two-thirds of the duty if these are produced or grown in the British Empire.

5. CUSTOMS DUTIES IN ENGLAND

It will now be convenient to review briefly some of the main features in the history of customs duties in the British Empire, in one or two continental countries, in the United States, and Japan. We are in search of principles rather than of detailed facts.¹

In Great Britain the history of customs is of great interest.

¹ Reference should be made to *History of Taxation and Taxes in England*, Stephen Dowell (Longmans, Green & Co., 1884), if a detailed history of the English system is desired.

It is possible to trace the history from the time when export duties on wool and import duties on wine were levied. In 1490 a retaliatory duty on malmsey wine from Crete was imposed as a counterblast to the heavy import duties levied by the Venetians until the latter should abate their new impositions. Up to the year 1700 customs duties were for revenue purposes and were approximately 5 per cent on imports and exports. The tariff, speaking generally, was arranged to yield the required revenue with the least possible effect on the trade of the country. The period 1700 to 1825 was a period of high protection, except during the peace years when Walpole was in power. This latter period extends from 1721 to 1742. It is said of Walpole that he found the tariff the worst in the world and left it the best. The exigencies of the State were so great in the eighteenth century that a 25 per cent duty was in vogue as early as 1759, and other articles, such as tea, coffee, sugar, tobacco, salt, wines, and spirits, paid much higher rates. Heavy duties were placed upon the importation of raw silk in 1765, and this continued for sixty years. From 1802 onwards import duties on wool were greatly increased and rose eleven-fold between 1802 and 1819. An import duty on tea was first levied in 1689 at 5s. per lb. The rate was so excessive that smuggling continued until Walpole, in 1723, introduced a warehousing system similar to that for pepper. On importation an *ad valorem* duty of 14 per cent was levied, and when removed from the warehouse a further (inland) duty of 4s. per lb. for home consumption was imposed. Later the duty was increased, and Pitt in 1784 reduced the tax from 119 per cent to 12½ per cent; in 1795 this was raised to 20 per cent, and in 1801 to 50 per cent, and in 1819 to between 96 and 100 per cent. In 1836 the rate was 2s. 1d. per lb., and Gladstone reduced it. From 1857 to 1863 it was 1s. 5d., and from April 25, 1863, 1s. To-day the rate is 4d. per lb. with a reduction of one-sixth of the duty on Empire-grown tea. The duties on tea, coffee, and chicory were reduced to one-half in 1924 in the first Budget of the Labour Government.

From 1825 commenced the period which is noteworthy for the large reduction in the number of articles on the tariff lists and for the policy of free trade. In 1660, 1630 articles were subject to duty; in 1781, 1425; in 1826, 1280; in 1841, 1052; in 1845, 1163; in 1849, 515; in 1853, 466; in 1859, 419; in 1876, 42;

and at the present time only 25,¹ excluding key industry goods. Since the abolition of the McKenna duties on imported motor cars, pianos, watches, clocks, cinema films, etc., from 1st August 1924 the number of such articles has become still less.

The reforms of Huskisson and Robinson in 1824 necessitated a further instalment of the reforms which Gladstone completed when Chancellor of the Exchequer. The duty on the import of foreign wool was reduced to one penny to suit manufacturers, while exporters were given the right to export on the payment of the same charge. The prohibition on the export of wool was thus removed, and foreign wool was admitted on the same conditions as home wool was exported. The protection given to the silk industry was modified by the reduction of the import duty on the raw material, and the prohibition on the import of manufactured goods was not removed until July 1826 in order that manufacturers might have an opportunity of preparing for competition. In 1825 the reforms of the previous year, instead of producing a loss of revenue produced a surplus. The high duty which prohibited the import of bar iron was reduced, and similarly the high duties on home coffee, cocoa, and wines were curtailed. Although Great Britain had no serious rival, cotton manufactures were actually protected by import duties ranging from 50 to 75 per cent. This was reduced to a uniform duty of 10 per cent on all cotton manufactured goods. In no case was a higher protective duty to be given than 30 per cent. A distinguished Civil Servant, James Deacon Hume (1774–1842), codified, as a result of these changes, the various customs laws in force, and on 5th July 1825 a Consolidating Act (6 Geo. IV. c. 105) was passed. In this act 443 statutes were enumerated, and the remaining acts were repealed by a general definition. The laws accumulated during the previous 550 years were done away with. In June 1815, it may be remembered, 1100 customs acts were in force.

Peel in 1841 was convinced that the recovery of industry was in some degree due to the lack of a simple tariff. Complicated duties strangled, in his opinion, trade, and he felt that a movement in a free trade direction was necessary owing to the circumstances at the time. The Report of the Committee on Import Duties appointed in 1840 recommended that duties should be charged

¹ *Vide* Fourteenth Report, Customs and Excise, Cmd. 1933, 1924.

on a small number of commodities in order to "facilitate the transactions of commerce, benefit the revenue, diminish the cost of collection, and remove the multitudinous sources of complaint and vexation". The principles on which the new tariff of 1841 was constructed were: (1) the removal of prohibitory duties or their reduction; (2) the reduction of duties on raw materials, not exceeding 5 per cent *ad valorem*; (3) the reduction of the duty on partially manufactured articles to a rate not exceeding 12 per cent *ad valorem*; and (4) the reduction of duties on manufactured articles to a rate not exceeding 20 per cent *ad valorem*. The revision necessitated changes in 750 out of a total of 1200 articles on which duties were paid. The tariff was further revised in 1845 and in 1856. The abolition of import duties on wheat (the Corn Laws) took place in 1846. The opposition to the repeal of the Corn Laws was mainly from the landed classes, whose power was immense for centuries before the introduction of the first Reform Bill. Gladstone completed the work which Peel had undertaken as Chancellor of the Exchequer in 1853, and removed completely in 1860 the protective features of the tariff.

The growth of the British Customs Revenue may be gauged from the following table:

BRITISH CUSTOMS REVENUE

	£ (Millions).		£ (Millions).
1688	1	1874	20.3
1714	1.6	1886	19.8
1785	4.5	1903	34.6
1802	9.9	1914	35.5
1817	11.9	1919	103
1842	23.5	1920	149
1847	22.2	1921	134
1854	22.5	1922	129
..	..	1923	123*

* Great Britain and Northern Ireland.

At the present time customs duties are imposed on the following articles: tobacco (including snuff), £53 millions; sugar, £39 millions; tea, £12 millions; spirits, £8 millions; and wine, £3 millions. These articles alone produce £115 millions out of £123 millions, the revenue from all commodities.¹ The remaining

¹ Estimates, 1923-24.

dutiable articles include cocoa, matches and mechanical lighters, motor cars, motor cycles, clocks and watches, beer, table-waters, cider and perry, coffee, chicory, dried fruits, motor spirit, cinematograph films, musical instruments, playing cards, perfumes containing spirit, soaps containing spirit, varnish containing spirit, ether, ethyle, collodion, chloral hydrate, and chloroform, together with certain key industry goods and depreciated currency goods. From 1st August 1924, however, the McKenna duties are to be abolished, as stated above. The duty on sugar is reduced to 1½d. per lb., the duty on sweetened table-waters is also to be abolished, and the 50 per cent increase in duty on dried fruits imposed in 1915 is not to be renewed. The total net receipts for the year ended 31st March 1923 were less than those for excise, the figures being respectively £123 million and £157 million sterling. Most of the articles are based on specific duties, the preferential duty being five-sixths of the full rate for tea, cocoa, coffee, chicory, sugar, dried fruits, tobacco, and motor spirit; and two-thirds of the full rate for cinematograph films, clocks and watches, motor cars and cycles, and musical instruments. For *ad valorem* duties the value taken is the price which an importer would give for the article if the article were delivered, freight and insurance being paid, in bond at the port of importation, and duty is payable on that value. As has been mentioned above, customs duty at the rate of one-third of the value is chargeable on the importation of depreciated currency duty goods, which include fabric gloves, domestic glassware, illuminating glassware for use with artificial light (not including electric incandescent lamp bulbs, miners' lamp glasses, or oil-lamp chimneys), domestic hollow-ware of aluminium, steel or wrought iron, mantles for incandescent lighting, and parts thereof. A similar rate of duty on key industry duty imports includes optical glass, scientific glassware, scientific and measuring instruments, wireless valves, magnetos, arc lamp carbons, hosiery latch needles, metallic tungsten, and synthetic organic chemicals.

Preferential duties came into force by Section 8 of the Finance Act, 1919. It is interesting to note that no less than 93 per cent of cocoa, 88 per cent of grain, 89 per cent of tea, 35 per cent of coffee, and 33 per cent of motor cars were imported from the Empire in 1922-23.

The protection enjoyed by the industries of Great Britain at present (May 1924) arise from five sources, viz: (1) the McKenna duties, imposed in 1915 in order to economise in shipping tonnage, on motor cars, motor cycles, cinematograph films, clocks and watches, and musical instruments; these duties are to be abolished from 1st August 1924; (2) the protection of dyes by the Dyestuffs (Import Regulations) Act, 1920; (3) the remission of countervailing excise duties on beet-sugar; (4) an *ad valorem* duty of £33 : 1 : 3 per cent up to 30th September 1926, levied under Part I. of the Safeguarding of Industries Act, on imports of optical glasses, magnetos, hosiery latch needles, tungsten and fine chemicals; and (5) depreciated currency duties under Part II. of the Safeguarding of Industries Act. The principal commodities under this part of the act protected are hollow-ware, fabric gloves, glove fabric, and illuminating glassware. Unless it be renewed this part of the act lapses on 19th August 1924.

6. THE DOMINIONS AND INDIA

In the self-governing Dominions and India protection is the order of the day. The percentage *ad valorem* rate of duty on dutiable imports in Canada was 24·5 per cent and 16·2 per cent on the total imports from all countries. The following table is of interest in this connection :

DUTIABLE IMPORTS—AVERAGE *AD VALOREM* RATE OF DUTY

	1922.
From Great Britain . . .	24·8 per cent.
From United States . . .	23·0 „
From all countries . . .	24·5 „

The revenue from customs was \$106 million in 1922 out of a total revenue of \$382 million. Canada adopted a protective tariff in the fifties of the last century. In 1859 Sir A. T. Galt, Minister of Finance, prepared a report emphasising the right of the Canadian Parliament to levy taxation,¹ as it deemed best, even though it may run counter to the wishes of the British Ministry. This doctrine was not challenged by the British Government. The Confederation of provinces, in 1867, led to the removal of the internal tariff barriers throughout Canada. There was a uniform

¹ The great part of taxation was then raised through customs duties.

tariff against all countries until 1897, when preference was granted to British goods by the remission of a percentage of the duty imposed. This method of preference was given up in 1904, and a specially low rate of duty on almost all dutiable commodities was adopted. At present there are three different tariffs—general, preferential, and reciprocal. The general tariff applies to all countries except those that come under the second and third. The preferential tariff applies to the British Empire, while the reciprocal or treaty tariff applies to countries such as the United States, with which special commercial treaties have been made. Special commercial treaties have been concluded with France, her colonies and protectorates, Belgium, Italy, and the Netherlands. The countries that are included under the reciprocal most favoured nation clause are the Argentine Republic, Colombia, Denmark, Japan, Norway, Russia, Spain, Sweden, Switzerland, and Venezuela. The Canadian customs tariff contains an anti-dumping clause. Drawbacks of 99 per cent of duties are also permitted on the raw materials imported when they are exported as manufactured articles. No duties have been collected on exports since 1892. During the War special duties were levied. In August 1914 the duties on coffee, sugar, spirituous liquors, and tobacco were increased. In 1915 *additional* duties of 5 per cent *ad valorem* under the British Preferential Tariff, and $7\frac{1}{2}$ per cent *ad valorem* under the Intermediate and General Tariffs, were imposed, but certain articles were exempted from these increases. In 1918 the duties on tea, coffee, and tobacco were increased. In 1919 the 5 per cent increase in the British Preferential Tariff was abolished and the $7\frac{1}{2}$ per cent increase in the Intermediate and General Tariffs was partially repealed. There were also other reductions in the rates of duty on certain articles, especially agricultural implements. Specific in place of *ad valorem* duties were imposed in 1919 on pig-lead, zinc spelter, and copper ingots. The Department of Customs and the Department of Inland Revenue were amalgamated in 1918 into one Department—the Department of Customs and Inland Revenue under one Minister of the Crown.

In Australia, under the tariff of 1921, about 46 per cent of the imports are subject to *ad valorem* rates, 25 per cent to specific duties, and the balance of about 29 per cent are free of duty. A comparison of the tariff now in force with that before the War

shows that the proportion of dutiable goods has increased from 57 per cent to 71 per cent. The average *ad valorem* rate of duty on dutiable goods has increased from 29.96 per cent to 31.93 per cent. The average percentage duty on all merchandise increased in the same period from 17.08 per cent to 22.63 per cent. The equivalent *ad valorem* rates of duty under the tariff of 1921 was 107 per cent on spirits, 85 per cent on tobacco, 53 per cent on ores, 41 per cent on jewellery and fancy goods, 35 per cent on rubber goods, 21 per cent on iron and steel, and 27 per cent on other manufactures of metals. The duty on apparel is 37 per cent, on leather 32 per cent, on textiles 22 per cent, and on miscellaneous goods 31 per cent.

From 16th September 1902 trade between the different States of the Commonwealth became free. Western Australia, however, reserved the right to levy duty on the goods of other States up to 1907. Changes were made in the overseas customs tariff in 1908, 1910, 1911, 1917, 1919, 1921, and 1922. The present Tariff Schedule provides a British Preferential Tariff and a General Tariff. The first can be applied to the British Dominions and the second to the British Dominions or to any foreign country. The General Tariff is in force against countries other than those coming under the British Preferential and Intermediate Tariffs. The Commonwealth Tariff Act of 1908 provided preferential rates for certain goods produced in the United Kingdom. The list of articles was enlarged and the margin in favour of the United Kingdom extended in 1914. To be eligible for preferential treatment the final processes of manufacture should have been carried out in the United Kingdom, and at least one-fourth of the value of the goods should be represented by British material or labour. In 1921-22 ninety per cent of British merchandise was preferentially treated, and the average margin of preference, viz. 12.61 per cent *ad valorem*, represented a loss of duty of £5,573,000. Preference to South African goods has been extended since 1906. From 1st September 1922 a preferential tariff has been extended to New Zealand. Negotiations for reciprocal tariff arrangements between Canada and Australia are in progress. The Customs Tariff Acts of 1922 made certain amendments in regard to wire, wire-fencing, wire netting, traction engines, sugar, golden syrup and sugar syrups. Since 1921 a Tariff Board of three members has been set up to whom the Minister refers for report questions

relating to the classification of goods for duty, the determination of the value of goods, the necessity for new, increased or reduced duties, the necessity for granting bonuses, the application of the different tariffs to the different countries, and complaints relating to the undue advantages taken by manufacturers by charging unnecessarily high prices. Provision is made for levying anti-dumping and depreciated currency duties. The revenue from customs amounted to £17 millions out of a total Commonwealth revenue of £65 millions in 1921-22.

In New Zealand a tariff of definitely protective intention dates from 1895. The tariff was revised in 1921. The number of items has been increased from 483 to 566. Under this tariff the general rate is 35 per cent, and for British preferential goods the rate is 20 per cent. There is an intermediate tariff which applies to countries which have entered into reciprocal trade relations with New Zealand. Most of the rates of duty in the tariff lists are specific, but an *ad valorem* duty ranging from 5 to as high as 60 per cent is imposed on some articles, 60 per cent being charged on apparel made in a foreign country to the order of a resident of New Zealand. Motor cars are charged 10 per cent under the British preferential tariff, and 25 per cent under the general tariff with an additional charge for car bodies. An extra rate of duty on goods ranging from 2½ to 25 per cent *ad valorem* is fixed in the case of countries with a depreciated exchange, and by the Customs Amendment Act, 1921, provision is made for a special dumping duty which may be imposed by the Minister of Customs on goods imported if the selling price to an importer is less than the current domestic value of the goods, and provided such imports will have a prejudicial effect on an industry established in the Dominion. In such a case the special duty shall not exceed the difference between the actual selling price and the current domestic value. The rates for British-grown tea, it may be noted, are 3d. per lb. in bulk, and 5d. per lb. in packages under 5 lbs. in weight, and, if the tea is grown outside the British Empire, the rate of duty is increased by 2d. per lb. In 1923 the 3d. per lb. duty on bulk tea from British countries was abolished, and a reduction of 3d. per lb. made in all other cases. From 30th September 1924 sugar, treacle, molasses, and syrup are to be free. The only export duty in force in New Zealand is that on timber (white-pine and kauri) at 3s. per 100

superficial feet for flitches, and 5s. per 100 superficial feet for logs. The yield from customs and excise duties formed 73·93 per cent of tax-revenue in 1904, 60·05 per cent in 1914, and 42·54 per cent in 1923. In 1922, 36·26 per cent of the import duties was derived from alcoholic drinks and tobacco, 26·44 per cent from clothing and textiles, 5·60 per cent from foods and non-alcoholic drinks, and the remaining 31·70 per cent from other articles. Customs revenue formed 25·31 per cent of the value of imports in 1895, 20·68 per cent in 1905, 15·35 per cent in 1914, and 15·51 per cent in 1922. The proportion of free to dutiable imports in 1922 was equal, viz. 49·60 per cent free and 50·40 per cent dutiable. New Zealand accords preferential treatment to Great Britain, and a reciprocal arrangement is in force with South Africa since 1907. Since 1st September 1922 New Zealand and Australia grant mutual concessions in the matter of customs duties under the Tariff Agreement Ratification Act of 1922.

Section 136 of the South Africa Act of 1909 has declared free trade within the Union.¹ The customs tariff is protective, and in certain cases prohibition of imports is possible. The *ad valorem* duties vary from 3 to 25 per cent. Duties from apparel, textiles, liquors, and metals including iron and steel are the main sources of revenue. With the exception of income tax, customs revenue is the principal head of the Union Government's revenue. The most important point regarding customs duties in South Africa is the preference accorded to goods the produce of reciprocating countries within the British Empire. As far back as 1821, the Cape Province taxed British goods at 3 per cent and other goods at 10 per cent. At present one-sixth of the duty at the specified rate is remitted on tea, coffee, cocoa, sugar, dried fruits, tobacco, and motor spirit; one-third of the duty at the specified rate is remitted on cinematograph films, clocks and watches, motor cars, motor cycles, and musical instruments; and in the case of wines 6d. to 1s. per gallon, and on spirits 2s. 6d. Act No. 35 of 1922 provides for protection in the case of goods coming from countries with a depreciated currency. Power is also given under the Act to the Governor-General to declare special rates of import duty in addition to the customs duties otherwise

¹ For the previous history of the customs in South Africa *vide Protection in South Africa*, by A. J. Bruwer, Stellenbosch (Pro Ecclesia Printing Works, 1923).

prescribed in cases where an industry in the Union is likely to be seriously affected by the import of goods from abroad. This protective duty will preclude the selling of goods at a lower price than the locally produced article. This protective duty is equal to the difference between the amount at which the foreign article is offered for sale in the Union and the wholesale price of the article in its country of manufacture plus cost of transit to South Africa. Thus for an article costing the equivalent of 6d. in Hamburg landed in South Africa, cost of freight being 1d., 7d. would be the price on importation. If the article is undersold for 5d. in South Africa the difference of 2d. is levied as duty.

The history of Indian customs duties is particularly instructive. It divides itself into four main periods : (i.) up to the year 1861 ; (ii.) the free trade period 1862 to the beginning of the War (1915); (iii.) the War and post-Armistice period (1916–1921); and (iv.) the period beginning 1922, the year in which the Indian Fiscal Commission reported. As a result of this Commission (i.) a policy of protection was advocated with discrimination “so as to make the inevitable burden on the community as light as is consistent with the due development of industries and to avoid abrupt disturbances of industrial and commercial conditions”,¹ and (ii.) a Tariff Board was set up.

Firstly as to period one. During the Mogul period customs duties were low. At Surat, for example, in 1609, they were 3 per cent on provisions, 2 per cent on gold and silver coined or uncoined, and $2\frac{1}{2}$ per cent on other goods. Delay, over-valuation, and compulsory sales by the customs authorities were not unusual. In the time of the Moguls the rate may be said to have approximated to 5 per cent *ad valorem*, although it was less in some places. There was also a system of internal land customs or transit duties, a system that was not done away with by the East India Company until 1844. In the forties of the last century there was a tariff of $3\frac{1}{2}$ per cent on raw materials and from $3\frac{1}{2}$ to 5 per cent on manufactured goods. If, however, the goods were carried in non-British bottoms these rates were 7 and 7 to 10 per cent respectively. From 1848 to 1859 differential duties on the basis of the origin of the goods were imposed in place of the

¹ Page 51, *Report of the Indian Fiscal Commission* (Simla, Superintendent, Government Central Press, 1922).

nationality of the shipping, the duty on British goods being one half of those on non-British goods. There was also a duty on most exports of 3 per cent *ad valorem* or a rate approximating to that figure. In order to balance the Budget the Right Hon. James Wilson increased in 1859 the general rate of duty from 5 to 10 per cent and certain luxuries had to pay 20 per cent. The luxury rate of duty lasted only for a year, as it was not productive. The duty on cotton yarn was raised in 1859 to 5 per cent from $3\frac{1}{2}$ per cent. Although export duties were levied at the rate of 2 annas per maund on grain, Rs.3 per maund on indigo, 4 per cent *ad valorem* on lac, and 3 per cent on most other articles, the Finance Minister exempted (in 1859) raw cotton, raw silk, sugar, and tobacco. Tea, coffee, wool, jute, raw hides and skins were freed from export duties in the following year. Saltpetre, however, had to bear a heavy export duty. These duties were for revenue purposes.

The free trade period from 1862 to 1915 may be conveniently divided into two periods, (a) 1862–1894 and (b) 1894–1915. The influence of the gospel of free trade had spread to India, as it had to the Dominions and the United States. The period from 1862 to 1894 is marked by a reduction and then by a general abolition of duties. Under financial necessity, Sir James Westland, Finance Minister, had in 1894 to reimpose duties, and in some cases to increase the few duties then in force, and this year marks the beginning in an upward direction of our revenue tariff.

In 1862 the duty on imported cotton piece-goods was reduced to 5 per cent, and on imported cotton yarn to $3\frac{1}{2}$ per cent. Two years later the general tariff was reduced from 10 to $7\frac{1}{2}$ per cent, and many articles were freed from duty. In 1867 the export duty tariff list was reduced from 97 articles to 9, and saltpetre was one of the articles on which an export duty was abolished. In 1873 wheat was no longer required to pay an export duty, and in 1875 the list was reduced to three articles—indigo, lac, and rice. In the same year (1875) the general rate of import duties was reduced from $7\frac{1}{2}$ to 5 per cent, the duties of 5 per cent on cotton piece-goods and of $3\frac{1}{2}$ per cent on cotton yarn remaining the same. The British Government directed the Government of India to abolish these cotton duties as soon as it was financially possible, and here we already have,

in the words of the Fiscal Commission, "the ill-omened shadow" of the cotton duties controversy on the tariff policy of this country. In 1878 the cotton duties were partially abolished, and in 1880 indigo and lac were removed from the export tariff list, rice alone remaining. In 1882 the general customs duty on imports and the remaining duties on cotton were removed, and only rice remained on the export list. Between 1882 and 1894 the only duties retained were those on arms, ammunition, liquors, opium, and salt, and from 1888 the half anna per gallon duty on petroleum. The duty on arms and ammunition was kept for administrative reasons, while that on liquors, opium, and salt was complementary to the excise duty on these articles.

A general import duty of 5 per cent was levied in 1894. At first cotton goods were imported free, but later on in the year an import duty of 5 per cent was necessary on both piece-goods and yarn, and a countervailing duty of 5 per cent on Indian yarn of counts above 20s. was also levied. Railway materials and machinery were placed on the free list, and a duty of 1 per cent was imposed on iron and steel. In 1896 the duty on cotton piece-goods was reduced as was the countervailing duty on Indian-made piece-goods to $3\frac{1}{2}$ per cent, cotton yarn being freed from the payment of customs or countervailing duty. From 1897 to 1910 the tariff remained practically the same as it was in 1896. In 1910-11 the import duty on liquors, tobacco, silver, and petroleum was increased. In 1902 the question of Imperial Preference was examined, but, as the Finance Minister (Sir Edward F. G. Law) phrased it, "in existing circumstances and in view of the fact that our exports consist almost entirely of raw materials and produce, it does not appear probable that materially important advantages could be offered to us under a system of preferential tariffs in our favour adapted for other parts of the Empire". The Fiscal Commission recommended that no preference should be given if it diminish the protection required by Indian industries. Such preference should not lead to any net appreciable loss to India, and it should not be granted without the consent of the Indian Legislature.

The third period—the War and post-Armistice period—shows clearly the effects of the War. The necessity for more

revenue led to an increase in the general import tariff to $7\frac{1}{2}$ per cent in 1916 and to 11 per cent in 1921. In the former year the free list was reduced, $2\frac{1}{2}$ per cent was imposed on railway material and machinery other than that for cotton mills, and 10 per cent on sugar. The duty on iron and steel was raised from 1 to $2\frac{1}{2}$ per cent, and the duties on liquors and tobacco were also increased. In 1917 the import duty on piece-goods was raised to $7\frac{1}{2}$ per cent, the countervailing duty on Indian-made goods remaining at $3\frac{1}{2}$ per cent. In 1921 cotton-mill machinery and stores were removed from the free list and a specific duty was placed on matches. Luxury articles, such as motor cars and watches, were taxed at 20 per cent. Export duties on raw and manufactured jute and on tea were imposed in 1916, and in the following year the jute export duty was doubled. In 1919 a protective export duty on raw hides and skins was imposed to protect the Indian tanning trade, and $66\frac{2}{3}$ per cent rebate was granted if exported to the British Empire for tanning.

The fourth period beginning with 1922 saw a rise in the general import tariff to 15 per cent. Matches, liquors, and tobacco pay high duties. Cigars and cigarettes, for example, are assessed at 75 per cent. The duties on iron and steel and railway material are 10 per cent, on cotton piece-goods 11 per cent, on cotton yarn 5 per cent, on sugar 25 per cent, and on confectionery, motor cars, cycles, tyres and tubes, glass bangles, silk piece-goods, and other articles of luxury, 30 per cent. The export tariff includes duties on raw jute and jute manufactures, rice, tea, raw hides, and skins. The tariff is not yet a protective tariff in the sense that the tariffs of the Dominions are. It is still mainly a tariff for revenue. The Tariff Board has, after great care, recommended the protection of the steel industry both by bounty and a protective duty, and that is indicative of the future of our tariff. The Government of India have accepted this proposal and placed it before the legislature, which also has approved it, and protection is now in force in regard to this for three years in the first instance. Other articles like paper are now under the consideration of the Board and the Government of India. The customs revenue is as follows :

		Lakhs of Rupees.	
		Pre-War Year (1913-14).	1921-22.
<i>Import Duties—</i>			
Cotton manufactures	. . . . .	2,13	4,84
Sugar . . . . .	. . . . .	92	6,51
Liquors . . . . .	. . . . .	1,34	2,16
Tobacco . . . . .	. . . . .	29	1,01
Matches . . . . .	. . . . .	..	1,04
Metals . . . . .	. . . . .	1,73	2,56
Others . . . . .	. . . . .	2,95	9,58
Total		9,36	27,70
<i>Export duties—</i>			
Jute . . . . .	. . . . .	..	2,72
Rice . . . . .	. . . . .	1,29	80
Tea . . . . .	. . . . .	6	46
Hides and skins (raw)	. . . . .	..	52
Miscellaneous		1,35	4,50
Total		10,71	32,20

It will be seen that import duties are now six times those on exports. More than 58 per cent of the import duty is collected from four articles, *e.g.* cotton manufactures, sugar, liquors, and metals. The total revenue from duties on imported cotton manufactures was Rs.484 lakhs as against Rs.219 lakhs from the countervailing duty of $3\frac{1}{2}$ per cent on the Indian-made article. About 88 per cent of the total value of imports are subject to *ad valorem* rates.¹ Eight per cent are based on specific duties, and the remaining 4 per cent are free of duty.

The customs duties that obtain in other parts of the British Empire do not require separate examination. In many colonies export duties are in force, as in the Federated Malay States, which produce rubber and tin, and the West Indies, which produce sugar.² The time is coming when Crown Colonies will have to spend money on the development of social services, such as education, sanitation, and medical relief, which will be a sound investment in the long run. The overhauling and perfecting of the customs system are in some of these already overdue.

¹ These include tariff valuations also.

² Cf. Chile's export duty on nitrates and Brazil's export duty on coffee, Brazil producing at least four-fifths of the world's coffee. Brazil also produces about one-half of the world's supply of india-rubber.

7. OTHER COUNTRIES

It will not be possible to review the history of tariffs in free-trade countries like Holland, Denmark, Norway, Switzerland, and Belgium, for reasons of space. The case of Great Britain has already been dealt with in some detail. It will also be impossible to review in detail the protective principles underlying the customs duties of France, Germany, Italy, the United States, and Japan. Protection as a national policy is evident in the history of France, as in the majority of countries. The revenue from customs in 1923 was only 1609 million francs or 10·1 per cent of the total tax revenue. Customs duties from sugar and salt are taxed through the customs and the excise, as are petrol, benzol, and one or two other products. Food and raw materials are subject to duty as well as manufactured goods. The same applied to Germany before the War. The French tariff is built upon the system introduced in 1791, together with a conventional tariff system based upon treaties. The reforms introduced by the law of 1892 fixed a maximum or general tariff extending to seven hundred items, and a minimum tariff, which allowed the import at special rates of goods of countries which gave similar concessions to French goods. Nevertheless, as one's eye goes down these tariff lists one is struck by the number of unproductive duties, and in this the French customs is in strong contrast with the British system. The duties on food-grains, like those in Germany and Italy, fell on the working classes, and it is doubtful whether the protective nature of the tax outweighs its drawbacks. France is much in need of a second Colbert to systematise (as the great Colbert did in 1664) the tariff with its long list of duty-paying commodities. In February 1924 the question of imposing a tax of 20 per cent on exports was contemplated. The alternative system of prohibition of exports with licences granted in certain cases was also discussed.

The tariffs of the United States ¹ and Japan are of importance. The early tariff history of the United States before the War of Independence shows a somewhat selfish policy on the part of Great Britain. Certain important articles could be exported only to Great Britain, and imports were possible only in British ships. That was, indeed, part of the colonial policy of the time.

¹ Cf. Taussig, *Tariff History of the United States*.

The duties on imports of 1773 were on rum and sugar from countries outside the British Empire. Even before 1816, when a definite protective policy took shape, there were attempts to protect young industries. But from the date of the Constitution (1787) to the end of the war of 1812 the tariff was intended for revenue purposes. Textiles, mainly cotton and wool, and iron, however, were protected commodities. Tea, coffee, liquor, and tobacco were those which were looked to as the main sources of revenue. From the second decade of the nineteenth century the idea of protection grew, except for a possible set back for fourteen years from 1846. The tariff of 1846, however, protected woollen and cotton goods to the extent of 20 per cent and iron 30 per cent. The Morrill tariff of 1861 increased the protective duties and introduced compensatory duties, so that if the raw material was taxed a corresponding duty was also added to the imported manufactured article to protect the home manufacturer. The tariff of 1864 placed on imports an average of 50 per cent, and in some ways was the high-water mark of protection. Possibly the Civil War compelled Congress to squeeze the utmost from its tariff. In 1890 the McKinley tariff reduced the duties on certain goods of industries which no longer required protection; but it increased the duties on other goods. Duties of a purely revenue nature were decreased. The Wilson law of 1894 reduced the protective duties of the previous law of 1890. The Dingley tariff of 1897 replaced the protective duties of the McKinley tariff, and the general rate of duties was increased. Textiles, iron, hides, leather, and sugar were protected. The Payne tariff of 1909 changed some of the rates in a downward direction, but its interest lies in the fact that it provided for a minimum rate plus additions by way of retaliation in the case of those countries whose tariffs were considered to be unfavourable to the United States. In 1922 the Fordney tariff of the Republican party became law, and went further in the direction of a high protective tariff.

The United States, with a vast expanse of territory and a large population, which, however, is still only a small part of what the country could support, is more self-contained than most countries of the world. It, therefore, can view without much anxiety the very high duties of the Fordney tariff. This great economic experiment may be due to the haunting fear that the

impoverishment of the chief industrial countries in Europe as a result of the War may be reflected in a lower standard of living in the United States if the products of cheap labour abroad were permitted to compete in the American market. The result of this tariff will make it more difficult than ever to purchase her exports, as the country will accept neither goods nor services, and gold she already has in no small measure. The restriction of imports to the extent that the Fordney tariff is likely to make will depress the prices obtainable for American products abroad through the scarcity of credits in the United States to pay for them. The difficulty for other nations to purchase American products may give rise to alternative sources of supply. The creditor position of America, already a matter of embarrassment, may be accentuated by this prohibitive tariff. The main imports now are (in order of importance) raw silk, sugar, coffee, oils, wood, chemicals and dyes, fruits, wool and manufactures of wool, india-rubber, fibres, and manufactured cotton. These were, in 1921-22, 57 per cent of the total imports. The main exports were raw cotton, grain, refined mineral oil, machinery, iron and steel, and manufactured tobacco, these exports in the same year being 52 per cent of the total.

The Japanese tariff has many points of resemblance to the Payne tariff just mentioned as well as to the French tariff of 1892. There is a general tariff and also a special tariff combined in the Import Tariff Revision Law of 1910, the basis of the present tariff. Custom-houses were set up in 1859, and the tariff revised in 1866. The tariff was not again revised until 1899, when a general tariff and a special tariff for countries with which tariff conventions had been concluded was laid down. A surtax was necessary on account of the war with Russia in 1904. In 1906 the tariff was again revised. The present tariff really dates from July 1911, being based on the Import Tariff Revision Law (No. 54) of 1910. At present there are 672 articles on the list, and specific duties are in the main collected on these. The rates on manufactured goods are 40 per cent and on some articles of luxury 50 per cent. For some manufactured goods the rates are below these, varying from 15 to 40 per cent; raw materials are mainly free, while partially manufactured goods are not assessed to heavy duties. Export duties were abolished from the beginning of the present century. Since August 1920 the tariff in force

in Japan has also been applied to Korea. The Conventions concluded with Great Britain, France, and Italy give special concessions of a reciprocal nature. Thus the Convention concluded with Great Britain guarantees that ten principal articles of export from Japan should be exempted from customs duties when imported into Great Britain, and concessions are made in the case of certain British imports into Japan, viz. paints, linen yarns, cotton and woollen goods, and iron sheets. The French minimum tariff rates are applied to certain Japanese products, and in return sardines in oil, butter, wines, olive oil, perfumes, woollen yarn and goods, binoculars, motor cars, and knitting machines are imported into Japan at reduced rates. Japan, like Great Britain, depends for its food-supply on foreign countries, and it builds up a large export trade for this purpose. It cannot live unto itself in the economic sense. In fact, exports and imports may be said to represent the diastole and systole of the commercial heart of Japan.

CHAPTER XXVII

INTERNAL TAXES ON COMMODITIES

1. THE indirect taxes dealt with in this chapter are excise duties (including Government monopolies, which are usually taxation in a special form) and octroi. In the succeeding chapter the remaining indirect taxes will be discussed—such as the turnover tax. Excise duties are an important source of revenue in most countries, as will be seen from the following table :

	Year.	Excise Revenue (Indirect).	Percentage of Tax Revenue.
Great Britain	1921-22	£189,162,000	22·2
India *	"	Rs. 29,61,84,000	21·9
Canada	1918-19	\$30,342,000	13·0
Australia (Commonwealth)	1921-22	£10,302,000	20·7
New Zealand	1921-22	£459,000	2·8
South Africa (Union) . .	1922-23 (estimate)	£1,095,000	6·3
France †	1923	Fr. 4,807,000	30·3
Holland	1923 (estimate)	Guilders 136,580,000	34·3
Germany (Reich)	1922-23 (estimate)	M. 5,500,000,000	4·8
Japan ‡	1922-23 (estimate)	Yen 391,971,000	46·5
Philippines	1920-21	Pesos 13,328,000,000	28·0

* Including salt (central and provincial revenues combined—salt being a central head) and excise duty on cotton manufactures and on motor spirit (both central).

† Includes excise, salt, monopolies of sugar, tobacco, and drinks.

‡ Includes liquor tax, sugar, excise tax on textile fabrics, monopolies, transit duties, and duties on soy, petroleum, and patent medicine.

In the case of State monopolies these have been included in the figures above, since these, in so far as the excess profit on the capital employed is covered, are undoubtedly taxation. In France tobacco, gunpowder, and matches, in Italy tobacco, salt, lotteries, and quinine, and in some other countries tobacco, are examples of State monopolies.

The main characteristic of modern excise systems is the great importance given to duties on wines, spirits, beet, and tobacco. Necessaries, such as sugar and salt, are also frequently taxed. But the number of articles which produce revenue is not large, and the extreme simplicity of Great Britain in this respect is very noticeable. The duties on wines and spirits promote sobriety as they prevent consumption, which would probably increase were there no tax. It is sometimes contended that States look too much to the financial results of their liquor policy, and, although they may spend their revenue on education and other social services, prohibition will never receive any effective support. The State realises that the drunkard is never a good taxpayer, except through the drinkshop, as his work is bad, his home poor, and his family has little to spend on necessities on which indirect taxes are frequently imposed. While realising, too, the effects of decreased consumption on improving the economic condition of its citizens—the larger bank balances¹ of workers in the United States have been urged as proof of this—it always insists that high drink duties mean illicit traffic unless accompanied by larger expenditure on more efficient administration. Each country, however, must survey its own particular problems and its own financial necessities before it decides on a revision of the form of its internal taxes on consumable goods.

2. Indirect taxation in England is usually said to have been introduced from Holland by Pym in 1643 when the Long Parliament resolved on the 28th March to have a system of excise duties.² An ordinance of the same date imposed duties on ale and beer, cider and perry, strong waters, and several other articles. In January 1644 flesh, victuals, and salt were added, and in July of the same year alum, hops, saffron, starch, silks, etc. were added. Before this period, however, indirect taxation seems to have existed to some extent, although there was a

¹ Thus in the State of Minnesota a savings increase of \$17,000,000 for 1920 is recorded. Cf. pp. 37 and 38, *Prohibition in America*, by Arthur Newsholme (P. S. King & Son, London, 1922). This, however, may in part be due to the good trade and high wages of 1920.

² Before this period there were traces of excise duties. In 1610 a petition of remonstrance was submitted to King James by the Commons: "Your Majesty hath lately and in time of peace, set both greater impositions and far more in number than your ancestors". They complained especially of the internal tax on coal at the pit, "the reason of this precedent may be extended to all commodities of this kingdom". Cf. Dowell, *History of Taxation and Taxes in England*, vol. i. p. 218, and vol. ii. (Bk. I.).

traditional hatred to taxes of this sort in the form of monopolies which constituted one of the methods of raising taxes on consumable goods, granted even before the time of the Tudors. It was, however, only under the Tudors that they were abused, especially under Elizabeth. In 1601 the list of monopolies included salt, currants, iron, playing cards, vinegar, and coal, and it is on record that the salt monopoly raised the price from 1s. 4d. to 14s. or 15s. per bushel. Queen Elizabeth promised to revoke all objectionable patents. In 1634, however, a company obtained a monopoly for salt. It was not until 1639 that most of the monopolies were revoked by proclamation, and the civil war that followed put an end to that troublesome matter. The system of excise duties introduced by the Long Parliament became not unpopular, and it prevented the wealthy landed classes from paying the heavy taxation that would have been required from them during the next two centuries. Consumers almost failed to realise that they were paying taxes. At first ale and beer, cider, perry, and strong waters were taxed, and this was followed by numerous articles of food and clothing, *c.g.* flesh, victuals, salt, alum, hats, starch, saffron, and silks. Between the Restoration (1660) and Sir Robert Walpole's excise scheme (1773) the tendency was to increase the list of articles. Walpole attempted to curtail the list. He also brought forward a Bill, generally known as the excise scheme (1773), to introduce what is now known as the Warehousing System, applicable first to tobacco and then to wine. This system was to decrease the frauds from smuggling and from drawbacks. The collection of the revenue was to have been cheapened and made more easy. The small loss to the State would be more than outweighed by the saving in the cost of collection and in the prevention of fraud. There was strong opposition, and there were fears that there would be a large army of revenue officials. There was a popular cry at the time of "no slavery, no excise, no wooden shoes", and did not Dr. Johnson define excise as "a hateful tax levied upon commodities, and adjudged not by common judges of property, but by wretches hired by those to whom excise is paid"? Walpole dropped the scheme. "I will not", he said, "be a minister to enforce taxes at the expense of blood." During the eighteenth century, especially owing to the wars with France, it was necessary to increase the excise duties. By 1792 they were £10,000,000

as against a shade over £1,000,000 in 1700. Glass, tiles, leather, soap, candles, salt, and other articles had been added to the inland revenue schedules. The tax on salt, which continued from 1694 to 1729 (when it was repealed), only to be renewed in 1732, was comparatively light. During the American War it was increased to 5s. per bushel and continued at this rate until 1798, when it was raised to 10s. Pitt in 1805 increased the rate to 15s.,¹ at which rate it continued until its repeal in 1825. The excise duties, thanks to the efforts of Huskisson, were reduced, and between 1830 and Gladstone's Financial Statement, 1861, excise duties on leather, candles, starch, bottles, glass, bricks, soap, and paper were abolished. A tax on soap was sometimes condemned as a tax on cleanliness, and a tax on paper as a tax on knowledge. The hop duty was abolished in 1862, and the malt tax was removed in 1880. The tobacco duty² is from home-grown tobacco. The excise duties³ at the present time are as follows :

	Net Receipts from Excise,* 1921-22.	
Beer	£121,845,000	14·3% of tax revenue.
Spirits	51,278,000	6·0 „
Entertainments †	10,280,000	} 1·9% „
Matches	2,122,000	
Patent medicines	1,328,000	
Table waters and cider . .	1,247,000	
Sugar	813,000	
Railways	191,000	
(On passenger receipts per £100 at fares exceeding minimum fares.)		
Tobacco (home-grown) . .	11,000	} 1·9% „
Other sources ‡	47,000	
Total	£189,162,000	* or 22·2% of tax revenue.

* Excludes the direct taxes, viz. licence duties, etc., amounting to £5,052,000. If this were included, excise amounts to £194,214,000, or 22·8 per cent of tax revenue.

† These are dealt with separately in Chapter XXVIII.

‡ Includes duties on cards, chicory, and coffee mixtures or substitutes.

¹ At this rate the tax was about 30 times the cost of production, which was only 6d. per bushel. A Committee of the House of Commons (1801) dealt with the smuggling and the salt laws generally.

² For the rates of excise duty on different articles see Reports of the Commissioners of H.M.'s Custom and Excise, H.M.'s Stationery Office, London.

³ For the detailed history of taxes on eatables, drink, tobacco, and others, refer to Dowell's *History of Taxation and Taxes in England*, vol. iv. (Longmans, Green & Co., London, 1884).

The Excise Department was under the Board of Inland Revenue, but from 1st April 1907 it has been amalgamated with the Customs Department. The control of British excise, therefore, is now under the Board of Customs and Excise.

3. In some other parts of the British Empire excise duties have long been in force. In the younger colonies the need for such duties has not arrived, but the experience of self-governing Dominions and India will be very useful in this respect. In the self-governing Dominions, as we have already seen, excise is a central head of revenue and amounts to 10·7 per cent of the total tax revenue on an average.

In Canada the excise tariff is confined to spirits, malt liquor, tobacco, cigarettes, Canadian twist tobacco, snuff and cigars, but the total amount of excise duties amounts to 13·0 per cent of the total tax revenue. Druggists and manufacturers of patent medicines are allowed a drawback of 99 per cent of duty when spirits testing not less than 50 per cent over proof are delivered in limited quantities to universities, scientific or research laboratories, or hospitals for medicinal purposes only. Spirits and tobacco alone were 80 per cent of the total inland revenue in 1913, 65 per cent in 1920, and 28 per cent in 1921. The decrease in the latter years is due to the increased yield of war taxes.

In Australia the Commonwealth excise revenue is confined to beer, spirits, tobacco, and starch, and also some direct taxes, as in the case of Great Britain, namely licences. The excise revenue is 20·7 per cent of the Commonwealth tax revenue. Excise duties were increased from 25th September 1918. In 1921-22 beer yielded more than half, and tobacco slightly less than one-third, of the Commonwealth excise revenue. Since 1917-18 the revenue from these two items has trebled itself. In New Zealand excise duties are confined to beer and tobacco and its preparations. By the Customs Amendment Act, 1921, excise duties are no longer levied on certain manufactures the preparation of which involve the use of a considerable proportion of spirits. A special reduced schedule of duties is provided on alcohol imported for use in warehouses manufacturing articles such as perfumed spirits, toilet preparations, culinary and flavouring essences, and similar preparations. The excise duties amount to 2·8 per cent of the total tax revenue. About 90 per cent of the excise revenue is collected from beer. All packages of manufactured tobacco must

be labelled before leaving the manufactory, and it is necessary to obtain warrants to use cutting machines for cutting duty-paid manufactured tobacco for sale. The revenue from excise was £127,041 in 1914 and £612,128 in 1923, or about five times the pre-War figure.

In the Union of South Africa excise duty is confined to spirits, beer, tobacco, cigarettes, sugar, matches, playing cards, acetic and pyroligneous acids, etc. The Cigarette Excise and Surtax Act 1911 applies throughout the Union, and the tax is collected from the manufacturer by means of stamps affixed to the container before cigarettes leave the factory, or from the importer at the time of first importation or delivery from a bonded warehouse. Manufacturers overseas are allowed to purchase the necessary stamps, and affix them to the containers of cigarettes at the time of manufacture. The excise duty for every one-half ounce net weight or fraction thereof is $\frac{3}{4}$ d. on all cigarettes manufactured in the Union, and on cigarettes imported into the Union and delivered for consumption therein a surtax (in addition to the duty payable under the Customs laws) is levied for every one-half ounce net weight or fraction thereof. The duty on Union-made matches is 6d. per gross of boxes containing not more than 100 matches, 1s. per gross of boxes containing not more than 200 matches, and so on in proportion to any increase in the size of boxes. Spirits yielded in 1920-21 about one-half, and cigarettes about one-fifth, of the total excise revenue. Next in order of importance were beer and sugar.

In India excise duties are derived from the manufacture and sale of spirits, hemp, drugs, opium, cotton manufactures, and salt, although the salt tax is administered independently of excise. There is as yet no excise duty on tobacco grown or manufactured in the country, nor on betel (*pansupari*), which is chewed by all classes of the population. Since the introduction of the new Constitution of 1919, excise other than salt and the cotton excise ¹ is a provincial source of revenue, while salt itself is wholly a central head. Opium is to all intents and purposes no longer a source of revenue, because it was decided, at very considerable loss to Indian revenues, to restrict the cultivation and export of opium, China undertaking to curtail its production as well as its imports. It is doubtful whether China has fulfilled her

¹ Cotton excise is included under customs.

agreement in regard to this. The anti-opium crusade was led in the United Kingdom by those to whom Sir John Strachey applied the words of Condorcet, "the ignorant enthusiast is the most terrible of ferocious beasts" ("l'enthousiaste ignorant est la plus terrible des bêtes féroces"). The excise duty on spirits is of long standing, and inherited, like the salt revenue, from the days of pre-British rule. References to intoxicating liquors are found in the Mahabharata and the Ramayana, and the British Administration got from its predecessors a system of farming, the right of manufacture and sale being given to the highest bidder. The general policy in recent years has been to adjust rates and methods to check the practice of excessive drink, and at the same time to safeguard revenue without encouraging illicit manufacture. In India country spirit, the produce of the distilleries, is the main source of revenue, yielding one-third of the total receipts from the sale of liquor. In the Madras Presidency alone fresh toddy from the cocoanut palm yields more than country spirit. The system in force is known as the contract distillery system, under which the manufacture of spirit for specified supply areas, determined according to convenience, is disposed of by tender for a definite period. In the most advanced province of India—the Bombay Presidency—a system of rationing coupled with Government management of certain large distilleries has been introduced since 1922. Prohibition is gaining ground in the reformed Councils, and it is only finance that stands in the way. The Excise Committee¹ of the Bombay Presidency issued its report in 1924, and advocated gradual prohibition—the Rs.3 crores of revenue from excise to be made up from a succession duty which it estimates will yield Rs.50 lakhs annually; a totalisator tax (Rs.20 lakhs); the taxation of "futures" (Rs.50 lakhs); increase of local fund cess (Rs.30 lakhs); a tobacco tax (Rs.5 lakhs); employee tax (Rs.40 lakhs); a transit tax (Rs.20 lakhs); and a terminal tax (Rs.50 lakhs). The Committee thought that the natural growth of revenue would make up the difference between Rs.3 crores and the sum total of the above. Drugs² which also

¹ Report of the Excise Committee appointed by the Government of Bombay, 1922-23 (Bombay Government Central Press, 1924).

² I.e. ganja (flowery tops of the cultivated female hemp plant), charas (resinous matter which forms an active drug when collected separately), and bhang (dried leaves of the hemp plant, whether male or female, cultivated or uncultivated).

bring in revenue are controlled. Of these, charas has been prohibited in the Bombay Presidency, excluding Sind, since 1922.

Salt, which Homer calls "divine", and Plato, a substance dear to the gods, has been taxed from very early times, just as in the Roman Imperial times "salary" represented the allowance of salt made to officers and men in the Roman Army and afterwards converted into a money payment. In India, as the population is largely vegetarian, and therefore requiring salt to an extent not required by meat-eating and milk-drinking people, salt is of importance. The consumption per head, according to family budgets collected by the Labour Office of the Government of Bombay, comes to 12 lb. per annum. The incidence of the tax is light. The average 20 years ago was only 4·9 annas per head of population, while in 1923-24 it was 5·7¹ annas. The recent reduction from Rs.2-8-0 in 1923-24 to Rs.1-4-0 in 1924-25 has brought down the incidence per head. According to the Finance Minister in his Budget speech in the Legislative Assembly, 1924, the increase in the salt duty to Rs.2-8-0 did not produce any decrease in consumption. At the present time most of the salt produced is manufactured under direct Government agency, and the remainder under a system of licences issued to contractors. There is a considerable amount of salt imported into Bengal and Burma from Europe and Aden, where, owing to the difficulty of manufacturing salt in the damp climate of Bengal and the large volume of fresh water poured by the Ganges and the Brahmaputra into the Bay of Bengal, manufacture is difficult.² Preventive establishments are maintained to restrict illicit traffic. Until 1st April 1924 salt and excise formed one Department, although salt is a central and excise a provincial head of revenue. Excise is a transferred subject under the reforms of 1919, and the result of the amalgamation was a weakening of the control of the Minister in charge of the Excise Department and also the deprivation of the Legislative Council of its statutory right of checking in detail the expenditure of the Department. In order to avoid disagreement between the Honourable Member of the Executive Council responsible for salt and the Honourable Minister responsible for

¹ Based on revised estimates.

² Salt is also used in place of ballast for ships coming to Calcutta for exports of jute, tea, rice, etc.

excise, the two Departments have been de-amalgamated, with effect from 1st April 1924. Salt is a central head of revenue.

The cotton excise duty dates from 1894. In December of that year, when the financial situation made it imperative to place import duties both on piece-goods and yarn to the extent of 5 per cent, an excise duty of the same amount was placed on the Indian yarn of counts above 20s. The Finance Minister, Sir James Westland, explained in introducing the Excise Duty Bill, that the policy underlying its provisions had been imposed on the Government of India by the Secretary of State in pursuance of a Resolution of the House of Commons. In 1896 the import duty on cotton piece-goods was lowered to $3\frac{1}{2}$ per cent and an excise duty at the same rate was placed on Indian-made cloth. Cotton yarn was admitted free of duty and no countervailing excise duty on Indian-made yarn was accordingly imposed. The excise duty remains at this level, although the import duty for cloth was raised to $7\frac{1}{2}$ per cent *ad valorem* in 1917, and to 11 per cent *ad valorem* in 1921. In 1922 cotton yarn, which had since 1896 been free, was subjected to an import duty of 5 per cent *ad valorem*. The cotton excise duty is regarded with disfavour because of its history. It may be noted that there is no duty

Items.	Revenue Rs.000.	Percentage to Total Tax Revenue.
<i>Excise—</i>		
Licence and distillery fees and duties for the sale of liquor and drugs	14,88,46	11.0
Gain on sale proceeds on excise opium	1,52,67	1.1
Duty on ganja	78,43	0.6
Miscellaneous	10,56	0.1
<i>Salt—</i>		
Excise duty on salt manufactured locally	4,08,80	3.0
Duty on imported salt	1,74,32	1.3
Sale of Government salt	43,03	0.3
Miscellaneous	18,05	0.1
<i>Opium—</i>		
Sale of opium	2,30,92	1.7
Cost price of opium sold by Excise Department	75,71	0.6
Miscellaneous	62	..
<i>Others—</i>		
Excise duty on cotton manufactures	2,19,17	1.6
Excise duty on motor spirit	61,10	0.5
	29,61,84	21.9

existing on jute manufactures, although from the point of view of the incidence of the tax this can perhaps be justified to a greater degree than the cotton excise duty. With the possible exception of the cotton excise duty, there is no tax on textile consumption like that which was established in Japan in 1905, a tax levied at the rate of 10 per cent of the value upon persons taking delivery, at the time of such delivery, of textiles from factories, custom-house compounds, bonded warehouses, customs temporary depots, and other places where the storage of foreign goods is permitted by laws and ordinances. The preceding table shows the revenue obtained from excise in India in 1921-22, and the percentage to the total tax revenue.

4. Excise duties in France may be grouped under two heads, those produced under monopoly conditions (undoubtedly a form of taxation) and those taxed as ordinary excise duties. To the former class belong tobacco, matches, and gunpowder, and to the latter sugar,¹ salt, drinks, and miscellaneous articles such as medicines, candles, passenger traffic, and playing cards. The figures are as follows :

				1923 (million francs).
Tobacco	.	.	.	1787
Matches, etc.	.	.	.	184
Sugar	.	.	.	516
Salt	.	.	.	35
Drinks	.	.	.	290
Miscellaneous	.	.	.	1995
				<hr/> 4807 <hr/>

Other indirect taxes, which hardly can be classified as excise, are dealt with below. It is perhaps advantageous to refer briefly to these taxes. The tobacco monopoly produced, it will be seen, very considerable revenue, incomparably greater than that relating to matches and gunpowder. Of the excise duties other than monopolies those on beverages such as wine, beer, cider, perry (pear cider), mead, alcohol, and mineral waters and sugar are of importance, and the miscellaneous group, such as pharmaceutical preparations, candles, cycles, passenger traffic, playing cards, is not inconsiderable. Salt produced

¹ In France salt and sugar are taxed both through the customs and through the internal revenue. The same is true of gasoline, benzol, and similar products

only 36 million francs in the year 1922. Owing to exemptions to persons and local discriminations, and also to other defects in administration, these duties were abandoned during the Revolution. The salt tax, for example, was abolished in March 1790, but restored in 1806 without being any longer a monopoly and without the old inequalities between the various provinces in France. The excise duty on liquors was re-established in 1804, and six years later the State monopoly of tobacco was also re-established. The salt duty or *gabelle* can be traced as far back as 1286, and Charles V. made it a permanent source of revenue. The fact that it was made obligatory on every individual to purchase weekly salt at a fixed price made the tax an inconvenient and unpopular one. From 1342 a State monopoly was begun by establishing storehouses in each province where the producer was compelled to store the salt on pain of confiscation. The State paid the producer and sold the salt at a higher rate to retailers. In one group of provinces it was heavy, in another it was less heavy, and in others it was redeemed or no tax was levied at all. Some of these taxes, such as those on drinks, *i.e.* on spirits and beer, are taxes at the point of manufacture, as in England. Other taxes, however, are levied so lightly that it is questionable whether they could not be replaced by better taxes. The French excise taxes not only contribute to the State but also to local finances, and those on drinks, tobacco, and sugar are well administered. Other taxes of the nature of *octrois* are dealt with in a subsequent paragraph.

5. In Italy there are monopolies on tobacco, salt, lotteries, and quinine, in addition to excise duties. The tobacco monopoly is a very profitable one, amounting to 2701 million lire in 1922-23, as compared with 171 million lire from salt, 329 million lire from lotteries, and 17 million lire from quinine. The excise duties are mainly from spirits, beer, mineral waters, sugar, gunpowder, butter, and cotton oil. There is in addition a system by which the State obtains revenue from *octroi*. The State grants to the communes one-tenth of the proceeds of the tax on incomes as compensation for communal revenues made over to the State by various laws. A criticism may be made of the comparative heaviness of this tax from a population even as poor as the Italian is said to be. But there are circumstances which preclude the collection of high duties like those on spirits

in the United Kingdom. In short, we come back to the theory explained in a previous chapter, that local circumstances have to be taken into consideration in the selection of the commodities, as well as the taxes to be levied on those commodities, in any excise system. In Spain and other countries monopolies are still in use and bring in considerable amounts of revenue. In Federal Germany the main indirect taxes are of an excise nature on tobacco, beer, wines, and a somewhat lucrative tax on coal ; but this does not include all the taxation, as State revenues are not included in these figures. The salt monopoly, which was changed in 1867 into a tax on the article, is still retained. There is also a sugar duty. In other countries of continental Europe drink duties and those on tobacco and sugar are the main source of excise. There is a tendency for greater uniformity than formerly, as the financial experts of various countries watch the duties levied with considerable interest. In Japan the main excise duties are those on liquors, soy, sugar, the consumption tax on kerosene oil—*i.e.* upon persons taking delivery of kerosene oil from factories, custom-house compounds, bonded warehouses, custom depots, or places where the storage of foreign goods is permitted by law—the tax on patent medicines and textiles, a consumption tax already referred to, together with the travelling tax on passengers by steam trains, electric cars, and steamboats according to the distance travelled and according to the class.

6. In China the main excise tax is the salt gabelle, which in 1922, after meeting administrative expenses, was approximately 86 million dollars, and this sum was paid into the Group Banks in accordance with the agreement in 1913. The obligations secured on the salt revenue were fully met, and the surplus funds released during 1922 for the Chinese Government amounted to nearly 79 million dollars, including 11 million dollars from the maritime customs. Of this amount, however, some 31 million dollars were sums either kept locally or appropriated by provincial authorities or military commanders. In December 1913 the Chinese Government definitely adopted the principle of uniform taxation at the source or the imposition of a single direct salt duty in the producing districts. Previous to that date the rates of taxation varied, and monopolies of transportation were granted to favoured individuals who made huge profits.

7. A reference has already been made to Japan. It remains

to summarise briefly the main excise duties at present in force. The revenue was approximately as follows :

	Yen (1000).	Percentage.
Sake (liquors, etc.)	188,839	48
Monopolies	101,323	26
Sugar	43,088	11
Textile fabrics	42,614	11
Transit	9,275	2
Soy	5,639	2
Petroleum	884	..
Patent medicine	309	..
	<hr/> 391,971 <hr/>	<hr/> 100 <hr/>

These duties far exceed the revenue obtained from customs, as the customs duties ¹ are framed on a protectionist basis. The tax on liquors is a tax imposed upon persons brewing sake, beer, and alcohol, and alcoholic liquors. No tax is levied upon wine or other alcoholic liquors made from fruits of all kinds. The revenue from monopoly is based on the Tobacco Monopoly Law of 1904. Government controls both the manufacture and the sale of tobacco. The cultivation of leaf tobacco is allowed to private individuals under permission of Government, and the leaf gathered by them is taken over by Government, suitable compensation being paid therefor, according to the quality of the leaf. The leaf is then manufactured at a Government Factory and sold at fixed prices by licensed dealers. Foreign tobacco cannot be imported except by Government. As regards the exportation of tobacco there is no restriction. Nearly fifty years ago tobacco regulations were issued in Japan, and the present system is developed mainly since the date of the abolition of the tax in 1898. The Salt Monopoly Law, like many other financial measures of the Government of Japan, was introduced after the war with Russia when the necessity for increased revenue was pressing. Salt is manufactured only by persons licensed by Government, which buys the article from them at suitable prices according to its quality. Government sell the salt to licensed dealers. Foreign and Formosa salt cannot be imported except by Government or a person appointed for the purpose by Government. For the purpose of export

¹ Customs duties were yen 71 millions only in 1921-22.

salt is sold by Government at reduced prices and can be exported by any person. Salt required for industry, agriculture, mining, or fisheries receives special treatment by being sold at reduced prices. Since 1918 the policy of profit-making has been abandoned in regard to salt, and the monopoly is now so managed as to cover expenditure and nothing more. Under the Camphor Monopoly Law, which dates from 1903, the manufacture of crude camphor and camphor oil is permitted only to persons licensed by Government, and Government takes over the article by paying suitable compensation according to quality. Crude camphor or camphor oil is sold by Government to refiners at fixed prices. A large amount of the Japanese camphor is consumed in the home market, and the produce of Formosa is exported mainly to Europe and America. Sugar excise, which dates from 1901, is imposed on sugar molasses and syrups removed for the purposes of domestic consumption from factories, custom houses, and bonded warehouses. The Textile Tax, which dates from 1905, is levied at the rate of 10 per cent, as already noted, upon textile goods for domestic consumption taken from factories, custom houses, and bonded warehouses. The travelling tax is similar to the travelling tax in England, and dates from 1905. It is imposed upon passengers by steam trains, electric cars, and steamboats. The soy tax is a tax upon persons manufacturing the Japanese sauce known as soy. No person is permitted to manufacture for household use more than five koku of soy per annum. The consumption tax on kerosene oil is imposed at the rate of yen one per koku upon persons taking delivery of kerosene from places of manufacture and bonded warehouses. The tax on patent medicines is fixed under the Patent Medicine Tax Law of 1905, and is included under receipts of stamp duties. A sum equal in value to one-tenth of the fixed price of the medicine is fixed on the package containing the medicine. A business tax is also imposed on persons importing medicines on a graduated scale, and varies according to the amount manufactured of each medicine during a twelvemonth. The taxes on petroleum and cotton fabrics press more heavily on the poorer classes than on the rich, but this is sometimes unavoidable when one looks at the tax system as a whole.

8. The system of excise duties known as octroi should be

considered in any discussion on excise taxation, as octroi taxes are collected on various articles brought into districts for consumption, and exist to-day mainly in France, Italy, Spain, Portugal, and in some towns in Austria and in North-Western India. In Great Britain, Holland, United States, and other countries the system of octroi taxation has been objected to and does not exist, as it is held to impede, as Adam Smith was never tired of showing, the trade between town and county, and at the same time it imposes considerable burdens on urban industries and consumers. Necessity, however, knows no law, and the system has been retained in some countries on this account. In the history of early boroughs in Great Britain goods going to market or passing through boroughs paid toll, a practice which exists in certain Continental countries to-day in the name of octroi. But to-day the system of taxing goods in this manner does not exist in Great Britain. Article I. section 10, of the Constitution of the United States of America prescribes that "no State shall, without the consent of the Congress, lay any imposts or duties on imports or exports, except what may be absolutely necessary for executing its inspection laws; and the net produce of all duties and imposts, laid by any State on imports or exports, shall be for the use of the Treasury of the United States; and all such laws shall be subject to the revision and control of the Congress". These octroi duties may be traced back to Roman times where cities were allowed to levy the *portorium*, a tax on the entry from or departure to a province. They were levied on wine and certain articles of food. The Romans introduced the taxes after the invasion of Gaul, and these remained after the invasion of the Franks under the name of *tonlieux* and *coutumes*. These octrois or grants were from the fourteenth century onwards granted to French towns by the king. In 1647 Cardinal Mazarin ordered that the proceeds of the octroi should be paid into the public Treasury, and at other times the Government claimed a percentage of the product. During the Revolution the octroi was abolished, owing to the abuses that had arisen, but, as the municipalities could not carry on without funds, Paris in 1798 was allowed to re-establish this form of taxation. By the law of 1809 octroi duties were allowed on (1) beverages and liquids, (2) eatables, (3) fuel, (4) forage, and (5) building materials. More than half the octrois were collected under the system of

régie simple, i.e. by means of special officers under the directions of the *maire*. The system by which a department of the Treasury collects the duties is also becoming more frequent. Farming of the duties and the system of sharing profits above a given sum with the municipality are now decreasing. From time to time proposals have been made to abolish octroi duties in France, but only half-heartedly, as in 1869. In 1871 octrois were entirely abolished in Belgium, being replaced by increases in customs and excise generally. In 1903 they were also abolished in Egypt, and in India the tendency is to do away with these taxes, terminal taxes on railways and direct taxation taking their place. In Paris the disappearance of octroi would mean the disappearance of a large net revenue obtained from meats (except horse-flesh), *delikatessen* products, game birds and poultry, preserved fish, butter, margarine, eggs, dry cheese, edible oils, and vinegar. The Government of France collect an additional one-tenth of 1 per cent of turnover as well as other taxes for the benefit of the communes, and this has taken the place of wines and the so-called hygienic beverages or light drinks in octroi lists. The net revenue to the city of Paris in the pre-War year was nearly 115 million francs, in 1920 116 million francs, and in 1921 147 million francs, the figures for 1920 and 1921 being preliminary figures. The Italian octroi duties, which date from 1864, are of interest from the fact that the State takes the duties. The articles taxed are similar to those in France. The taxation of certain classes of goods such as building materials is similar to that in France, and the family budget of the working man is to some extent affected by these duties. It cannot be said that octroi duties are equitable between class and class or between place and place, but, as already pointed out, they have become so customary that they are not difficult to collect, and at the same time their abolition would mean, especially in a large town like Paris, a considerable blank in the revenue.¹

¹ For octroi in local finance, especially in Germany, see Chapter XXXII.

CHAPTER XXVIII

OTHER INDIRECT TAXES AND FEES

SCOPE

1. "THERE is no art", says Adam Smith, "which one Government sooner learns of another, than that of draining money from the pockets of the people."¹ In recent years miscellaneous taxes have increased in number and in productivity, and a discovery in one country of a productive indirect tax has led to its adoption in another in a surprisingly short time. The more important of these other indirect taxes and fees are stamp and registration duties, including Stock Exchange taxes, business or turnover taxes, and the taxation of betting and amusements. It will be remembered from the definition of direct and indirect taxation² that these are mainly examples of indirect taxes. Their importance, especially in the War and in the post-armistice period, has not been inconsiderable. In India stamp duties and registration are at the present time 9 per cent of the total tax revenue, and in France 7·5 per cent. In South Africa the percentage is 5·2 and in Great Britain 2·5. The turnover tax which has been so productive in France and Germany was 19·1 per cent of the total tax revenue in France in 1923, and 31·6 per cent of the total tax revenue of Germany's Federal finance in 1924. Stamps and registration are usually grouped together, but in India and not a few other countries they are not combined. The revenue from stamps should not be confused with the revenue from postage stamps, which is usually credited to Posts and Telegraphs, a share sometimes of receipts from penny stamps being credited to stamps

¹ *Wealth of Nations*, Bk. V. chap. ii. part ii. appendix to articles 1 and 2.

² Chapter XIII.

in view of the fact that adhesive stamps are permitted for receipts and certain other documents. Fees are levied in order to defray usually a part, in rare cases the whole, of the cost of services done in the public interest and conferring some degree of advantage on the fee payer. They may be divided into judicial, commercial, and other fees. In addition to taxes referred to above, there are quasi-taxes, such as the issue of paper money which may be used either directly or indirectly as currency inflation to raise revenue. The printing of paper money is a form of enterprise which leads to disastrous effects on production. The experience of Germany in 1923 was that inflation resulted in favour of business men at the expense of those on fixed money incomes and also wage earners. It is, in short, a regressive tax. Before long the confidence of the whole community becomes lost in the future value of its currency, as was so well illustrated in the flight of the mark. A fall takes place in the internal and external value of the currency.¹

STAMP DUTIES AND FEES

2. The tax on stamps was introduced from Holland into Great Britain in 1694. Seventy years previously the tax had been discovered in Holland in response to a proclamation of the States-General offering a prize for the invention of a new tax. The duty was first of all a duty on paper or parchment which was presented at the Government Stamp Office for stamping. There were six different stamps, one of 40s. as a payment for royal grants of land and presentations to ecclesiastical benefices. There were five smaller stamps of 5s., 2½s., 1s., 6d., and 1d., for

¹ Cf. "Inflation as a Method of Taxation" (chap. ii. Keynes's *Tract on Monetary Reform*, Macmillan, 1923). It is to be noted that "the burden of the tax is well spread, cannot be evaded, costs nothing to collect, and falls, in a rough sort of way, in proportion to the wealth of the victim. No wonder its superficial advantages have attracted Ministers of Finance. . . . What is raised by printing notes is just as much taken from the public as is a beer duty or an income tax. What a Government spends the public pay for. There is no such thing as an uncovered deficit. But in some countries it seems possible to please and content the public, for a time at least, by giving them, in return for the taxes they pay, finely engraved acknowledgements on water-marked paper. The income-tax receipts, which we in England receive from the Surveyor, we throw into the wastepaper basket; in Germany they call them bank notes and put them into their pocket-books; in France they are termed Rentos and are locked up in the family safe" (*op. cit.* pp. 43 and 62).

numerous other legal instruments specified in the Act.¹ The charges were thus fixed according to the class of instrument, and to a certain extent were a tax on the amount of paper used. In 1797 the *ad valorem* principle was introduced except for property. Until 1808 the tax varied mainly according to the length of the document in the case of property. In 1815 *ad valorem* duties became general. In 1850 percentage duties were introduced on bonds, conveyances, mortgages, and settlements. In 1853 a penny was fixed as the postage on receipts in place of the varying rate according to value, namely, 3d. to 10d., and ordinary stamps were permitted to be used. In 1891 the Consolidating Stamp Act was passed, and it provided for an *ad valorem* duty on (1) property, bills of exchange and promissory notes; (2) penny duties on receipts, cheques, etc.; and (3) fixed duties on deeds and instruments not mentioned above. This Consolidating Act prescribed penalties such as £10 for the non-receipt of a document and the making void of any agreement not stamped. At the present time the receipt for £2 or upwards is 2 pence, the penalty for not stamping is £10.

It will be seen that some duties are charged on documents and writings having a legal operation or forming necessary steps in law-suits. These duties are collected by means of stamps impressed on or affixed to the instruments. In addition to these there are duties on commercial documents, such as bills of exchange and contract notes, companies' capital duty (which amounts to £1 on every £100 of the nominal capital of companies or corporations with limited liability and 2s. 6d. on loan issues by local authorities, companies, and corporations on every £100 secured), insurance, drafts, and receipts. Under the Stamp Act of 1891, postage adhesive stamps, it may be noted, are permitted for bills of exchange, including cheques, for payment of money on demand, certified copies or extracts from registers of births, charter parties, leases of dwelling-houses not exceeding a year at a rental not exceeding the rate of £10 per annum, or of any furnished dwelling-houses for any definite term less than a year where the rent for such term does not exceed £10, receipts, policies of insurance (not life nor marine), proxies, and voting papers. In the United Kingdom most of the stamp duties are from deeds, the amount of revenue being 43 per cent of the total stamp duty

¹ 5 & 6 William and Mary, c. 21.

revenue in 1921-22. Receipts and drafts amounted to 26 per cent, companies' capital duty to 11 per cent, bills of exchange to 7 per cent, insurance 5 per cent, bearer bonds 4 per cent, and others 4 per cent. The fee stamps proper include judicature fee stamps, land registration fees, and other fee stamps for companies' registration, district audit, civil services commission, and registered houses (Scotland). It is interesting to notice that these stamp duties reflect frequently the state of trade of the country. In Great Britain, for example, in 1921-22, as compared with the previous year, there was a decline from £27 millions to £20 millions in stamp duties, of which decrease £2½ millions were on account of conveyances. There were also decreases in the receipts from cheque stamps, bills of lading, and shipping policies owing to the trade depression of the year. In some countries stamp duties have not been changed for long periods, notwithstanding a considerable change in the level of prices and in the cost of the judiciary. Financial pressure, as also the economic changes, especially of prices of a more or less permanent nature, have in some countries produced a revision. Nevertheless there are some who hold that stamps for judicial acts, unlike those for ordinary commercial instruments, should not be raised unduly. In a well-known passage Jeremy Bentham writes of "attacks upon security committed through ignorance, inadvertence, or false reasons", and he includes among them taxes upon law proceedings. He says that "they include all kinds of attacks upon security, since they are equivalent to refusing the protection of the law to all those who cannot pay for it. They consequently offer a hope of impunity to crime. It is only necessary to choose as objects of injustice individuals who cannot afford the advances necessary to a judicial prosecution, or who are not rich enough to run the risk".¹ This reminds one of the well-known saying in the Santi Parvan of the *Mahabharata* that "the king should act like the leech taking blood mildly. He should treat his subjects like a tigress carrying her cubs, touching them with her teeth, but never cutting them therewith".² A tax on legal process may be a hindrance to the use of the courts, but it must be remembered that taxation of Acts is a subordinate one in the tax system of most modern countries.

¹ Bentham, *Theory of Legislation*, p. 140 (London, Trubner & Co.).

² Chapters lxxxviii. and cxxix. Santi Parvan.

TAXATION OF BETTING

3. Another group of indirect taxes includes those concerned with lotteries and betting. In the past States raised money through the taxation of lotteries, and even built churches with the proceeds. St. John's Cathedral in Calcutta was the result of this, and not a few town-halls owe their origin to this form of taxation. To-day Governments, such as the Government of Italy, are controlling such forms of gambling by means of taxation. In connection with public loans, a reference will be made to State lotteries, especially those which prevailed in England between 1694 and 1826. Here we are concerned with the taxation of private lotteries and not with State lottery loans. Lotteries like the well-known Calcutta Sweepstake, which frequently awards prizes of over £50,000, certainly are fit subjects for taxation, just as the taxation of betting. The attitude towards the taxation of betting has changed remarkably in recent years, especially in the Self-Governing Dominions. It is realised that, although betting may be a mug's game, still taxation is both practicable and desirable. By no twist of the imagination can it be held that by being taxed and made lawful betting will be further encouraged. As in the case of drink, it is somewhat likely to be checked than further promoted by regulation, and certainly taxation would diminish the malpractices associated with it. A wrong thing is not encouraged by diminishing the money profits from its practice. The real question before the financier, and indeed the only question, is whether the probable contribution to the Budget is sufficiently substantial to make the tax worth while. The gambler on the Stock Exchange contributes in many countries by stamps on his contracts his share of taxation to the State. Stock Exchange transactions are taxed only when States see that it is worth their while. The taxation of betting, although in the nature of luxury taxation, does not deserve to be included under the group fancy taxes. An ex-Lord Chancellor, speaking in the House of Lords in March 1924, remarked that "to say it was a shocking thing to legalise betting was merely to show the depths of hypocrisy in which we were living in regard to matters of this kind. Was it not legalising betting to charge income tax upon the bookmakers' profits, or for the Post Office to say they held themselves in readiness to transfer the bets from

the man who made them to the man who had the office for betting? The whole argument was the most arrant hypocrisy." The method of effecting the taxation of horse-racing, football, and similar matches, where betting does take place, has been thought out carefully, especially in Australia. The Federal Government collects a tax on tickets for admission, except those issued at a very low figure. This, however, belongs to an amusement tax. The State Governments levy a tax on betting tickets which are stamped, the highest stamp being usually 3d. in New South Wales and Victoria, the rates of tax being lower in suburban areas. The Tax Department issues the tickets already stamped, so that the bookmaker wanting any number can have them on application. In New South Wales the practice is for the bookmaker to send his tickets, already printed, to the stamp office, and to have them stamped by Government agency. In Victoria Government prints the tickets to safeguard against fraud, and the tickets are numbered. In addition to a tax on betting-tickets, there is a special tax levied as a licence on bookmakers, amounting to a maximum of £50 in Victoria and £70 in New South Wales. In addition to these there is a tax on the totalisator at races. In New South Wales racecourse betting with the totalisator reached over £600,000 in 1921-22. If it be remembered that the population of the State is two millions and that the highest tax is 3d., an idea can be formed of how productive such a tax can be. In Great Britain a considered scheme was put forward by the Board of Customs and Excise, and published in 1924 in the Report of the Select Committee appointed to consider the question of imposing a duty on betting.¹ This scheme proposed not only to register and license all bookmakers and their premises, and lay the responsibility for paying the duty on the bookmakers, but to legalise ready-money betting and place 2½ per cent duty on all amounts staked as bets. The details of the scheme were as follows: (1) to levy an *ad valorem* duty on all the amounts staked as bets with professional bookmakers, the bookmaker to be responsible for the payment of the duty, and heavy penalties to be imposed on bookmakers acting without a licence; (2) to make cash betting off racecourses legal on condition that it takes place in registered betting-houses, all betting-houses, even those where credit betting only is carried on, to be registered; (3) the amount

¹ No. 139.

of duty charged for registration of a betting-office to be £20 annually, and the machinery for the collection of the tax to be on the model of that of excise, which would require the licensing of bookmakers and the registration of their premises. The method of collecting the duty was to be as follows : " For ready-money betting the Government would issue at the Post Office and at the Board of Customs and Excise and on racecourses books of tickets containing a number on which the duty amounts to a round sum. For example, a book would contain say 100 tickets for 1s. bets at a cost of 2s. 6d. (*i.e.* $2\frac{1}{2}$ per cent on £5) or 100 tickets for 2s. bets at the cost of 5s. (*i.e.* $2\frac{1}{2}$ per cent on £10). Similarly a book of 50 tickets for £1 bets would cost 25s. or $2\frac{1}{2}$ per cent on £50. The tickets would be differently coloured for each denomination of bet, numbered consecutively, and stamped or not, as thought desirable. The bookmaker would issue to the backer a ticket for the amount staked. Thus the tax would be collected automatically. In the case of credit betting the Board of Customs and Excise would arrange to collect from the bookmaker the tax due, as shown by his books on weekly or monthly returns, if he was in a position to give adequate security to the Crown for payment of the duty. Failing this, a Government ticket would have to be given for each credit bet : in practice this would hardly ever occur." Strong provisions to prevent evasion of the taxation or fraud were to be inserted in the Act. The cancellation of registration would be the strongest protection for the revenue in the case of office bookmakers, and forfeiture of licence in the case of evasion by racecourse bookmakers. This scheme, however, was not given effect to.

TAXATION OF AMUSEMENTS

4. The taxation of amusements has been in existence mainly in Great Britain, Australia, New Zealand, South Africa, and in India. In Australia the legislation is federal and provincial, there being provincial Acts in Tasmania and South Australia. In Tasmania the whole of the tax leviable under the Commonwealth and Tasmania Acts is collected by the Commonwealth, the Central Government handing over to the State Government without any deduction for the expenditure of collection the portion belonging to the State. In consideration of this, the

services of the State Police in the way of supervision are given free of charge.¹ In India two Governments only, those of Bombay and Bengal, introduced the tax. There is no tax imposed by the Central Government. The amusements tax, like other expenditure taxes, was introduced at a time when it was necessary to levy as much taxation as possible on all forms of luxury expenditure and to encourage saving. The War, however, showed that a tax on luxury, unlike that on tobacco and spirits, which are conventional necessities, cannot always be looked on as a productive source of revenue. There are taxes, however, such as the amusements tax, which falls ultimately on those who indulge in certain forms of amusement, and yields large amounts of revenue. Some countries regard the tax as a non-permanent tax, while others regard it as a permanent or quasi-permanent part of the tax system. In 1921 the House of Representatives of the Commonwealth of Australia repealed the Act, but it was defeated in the Senate. Questions have been asked in the British House of Commons regarding the repeal of the Act in Great Britain, but the Act still continues. The Royal Commission on Taxation in Australia² recommended that it was somewhat in the nature of emergency legislation, and its repeal should be considered when the state of public finance rendered such a course possible. There is much to be said in favour of the tax where it is productive. In Great Britain in 1921-22 it was 1·2 per cent of the total tax revenue, bringing in £10 millions, and in Australia the federal tax was 1·5 per cent of the federal tax revenue, bringing in £700,000. In Bombay the net receipts amounted to Rs.9 lakhs or £60,000 in 1923-24. Its effects have not been deleterious, although conditions have not been sufficiently normal to consider such effects in detail. The main objections against amusements or entertainments taxes are that they are unequal because certain amusements only are taxed. It might also be said that the tax discourages amusement or recreation, which is essential for the well-being of the community. The important points in the taxation of amusements centre round mainly the definition of amusements or entertainments and also the meaning of "payment for admission", "proprietor", etc. In most countries entertainment includes any exhibition, performance, lecture, amusement, game, or sport for admission to

¹ Section 5A of the Amusements Duties Amendment Act, 1917.

² F 18112, 5th and final Report, 1923.

which payment is made. Exemptions are usually allowed in cases where the whole of the proceeds are devoted to philanthropic, religious, or charitable purposes without any charge of the proceeds for any expenses. Entertainments of a wholly educational character or only for the amusement of children, or partly educational and partly scientific by a society, institution, or committee not conducted for profit, are exempted. In Australia the taxing of payments for articles supplied by the proprietor for the purpose of an entertainment, such as skates, are to be included in the "payment for admission". The rates of tax are progressive. In Great Britain an entertainments duty came into force from 15th May 1916. The rates as fixed by the Finance Act of 1919 varied from a halfpenny on payments of 2½d. and below to 2 shillings for the first 15 shillings, and 6d. for every 5 shillings or part of 5 shillings over 15 shillings. In the Budget for 1924-25 the duty was repealed on tickets up to the value of 6d., and reduced on tickets from 7d. to 1s. 3d. This repeal and reduction are expected to cost £4,000,000 in a full year. In the Australian legislation the Commissioner is given extensive powers which he can delegate. The penalties for evasion vary from £5 in the case of a person admitted to £50 in the case of a proprietor guilty of an offence. Certain offences are indictable such as forging a die or stamp, fraudulently mutilating any stamp with the intent that any use may be made of any part of the stamp, and the maximum penalty is 14 years' imprisonment. Other offences involve the liability to imprisonment for 7 years, 3 years, and 1 year. A sum of £50 is fixed as the maximum penalty for any breach of the regulations. It will be seen, therefore, that, if proper steps are taken to prevent evasion, the tax is a good luxury tax and one that is not troublesome to collect. In some places complaints have been made, as in Australia, that there has been delay in obtaining registration under the Commonwealth Act in remote districts. This difficulty has been surmounted by a system of registration to be made with local postmasters. In India in the Bombay Presidency the cost of collection of the entertainments tax is low. The receipts for 1923-24 were Rs.9,41,442 and the cost of collection Rs.22,397 or 2·3 per cent. Recently the Bombay Government imposed certain restrictions on the issue of free tickets to places of amusement.

TAXATION OF BUSINESS AND TURNOVER

5. Another class of indirect tax is that which may be called a business tax or turnover tax. In some countries, as we have seen, licences and certificates for professions and occupations are in vogue. In South Africa and Australia business taxes are chiefly in the form of licences. In Japan there is an exceedingly complicated tax known as the business tax. The best form of business tax, however, is the well-known German and French turnover tax. The business tax in the sense here used is confined to taxes such as that levied in Japan upon every description of commerce and industry. The tax is based mainly on the sales of every business, and is closely allied to the turnover tax—also a sales tax which has been so remarkably successful in Germany and in France. In order to make the Japanese tax more equal in its incidence the assessment is made on the amount of sales, on the amount of capital, on the rental value of the buildings, on the number of employees including labourers, and in the case of agency, brokerage, etc., the amount of commission and the employees in the firm. The business tax on the sale of goods is 8/10,000 on certain businesses such as those dealing wholesale or retail in rice, wheat, beans, petroleum, manures, salt, tobacco, firewood, and charcoal, and 11/10,000 on certain other classes of business, the retail rates on the amount of sales being 20/10,000 and 30/10,000 respectively for these groups. The rate of tax on the rental value of buildings is 70/1000, and for employees the tax is 2 yen per head. On banks the tax is 4·5/1000 on the amount of capital, 70/1000 on the rental, and 2 yen for each employee. For broking, etc., the tax is 30/1000 and 2 yen each on employees. For purposes of assessment, occupations are classified into 12 groups. Any business which does not reach the fixed assessable value, or any business not included in the list of businesses, is not subject to the business tax, but is subject to purely local taxation.

The German turnover tax amounted, as we have seen, to 31·6 per cent of the total federal tax revenue in 1924.¹ The French tax amounted to 17 per cent of the total revenue² and 19·1 per cent of the tax revenue. Both taxes are similar, and a description of the French tax will show how it is levied. From 1920 monthly statements of sales or transactions are taxed at

¹ Estimates for 1924–25.

² 1923.

1, 3, or 10 per cent. The tax is entirely separate from any profits, as for example, a business which has a loss would have to pay a tax on the volume of its sales. The tax falls on those who "habitually or occasionally buy in order to resell", and includes the small shopkeeper or the artisan working on his own account, the dressmaker, etc., as also brokers. Stocks and shares already subject to stamp and other taxes are not subject to the turnover tax where the Stock Exchange broker or seller is concerned, but the bank or other agency pays the tax on the amount of its remuneration. The liberal professions which are taxed on incomes, commercial travellers and farmers who sell their own produce, public service corporations whose fees are fixed by Governments, those who sell bread, certain co-operative societies, hackney carriages, etc., are not subject to the tax. In Germany a similar system prevails. In Prussia the tax was levied only when the turnover exceeded a specified limit. In Bavaria both States and communes levied this tax. In 1924-25 the federal tax on turnover was estimated to produce 1440 million marks. The taxation of corporations might also have been included as a business tax, but, as noted in another chapter,¹ this form of taxation has been included under the taxation of surplus in view of the surplus incomes which the corporations receive owing to their existence and privileges as corporations. It is not possible to deal in detail with other isolated taxes such as that in the United States on the circulation of national banks.

This chapter has been concerned mainly with taxes on expenditure. In so far as such taxation is on all expenditure including necessities as well as luxuries, it will tend to raise the cost of living. In so far as the cost of living is raised the tax will, other things being equal, press more heavily on the poor than on the well-to-do.

¹ Chapter XXIV.

CHAPTER XXIX

THE BURDEN OF TAXATION

1. TAXATION lessens the resources in the hands of private individuals and transfers to public authorities the proceeds to be expended on different services. The idea of burden arises from the fact that (1) there is no direct connection visible between the amount contributed in taxation and the services received by the individual. There is the absence of a *quid pro quo*; (2) taxation is compulsory, and is therefore felt as a burden; (3) funds are taken by public authorities which would otherwise have been used for private consumption or private saving. The creation of new work and new capital is thus penalised. States may spend, as for example on social services, money more judiciously than the private individual if the money were left in his pocket, but often the money is spent by the States on wars and on armed peace; (4) with the development of States, taxation has enormously increased, as the king could not, as in early times, live on his own. After great wars taxation has increased so rapidly that its weight is all the more felt. In this chapter we are concerned more with the individual burden than the social burden of taxation. In order to discuss fully the social burden it would be necessary to analyse the method in which the various countries spend their tax revenue on social services and on other heads of expenditure. To this a reference has already been made in the chapter and the tables on the distribution of expenditure.

The real burden of taxation in its relation to national income has received considerable importance in the present century, especially since the War, by many writers on public finance. An investigation of national income has been made, notably by

Stamp¹ in England, Gini² in Italy, Knibbs³ in Australia, Helfferich⁴ in Germany, and by Pupin⁵ and Théry⁶ in France. Taxation is, as has been shown, the transfer of a part of a taxpayer's spending and saving power to public authorities, and the burden of this varies with the income of the individual and of the nation as a whole. The State takes from its citizens certain sums which it disburses in wages, salaries, materials, and social services. It is important to test the progress in the same country at different periods and to test the prosperity between different countries at the same period, and also to study the yield of certain schemes of taxation by an examination of all the facts. In the Treaty of Versailles it is provided that the Reparations Commission should periodically estimate Germany's capacity to pay and that the German scheme of taxation should be "fully as heavy proportionately as that of any of the Powers represented on the Commission".⁷ In Great Britain the Chancellor of the Exchequer appointed in March 1924 a Committee of 12 under Lord Colwyn "to consider and report on the national debt and the incidence of existing taxation with special reference to their effect on trade, industry, employment, and national credit". In India Sir Basil Blackett, the Finance Minister, announced in the Legislative Assembly that a Committee would sit "to examine the manner in which the burden of taxation was distributed between the different classes of the population, and to consider among other matters

¹ "National Wealth and Income of the Chief Powers", *Royal Statistical Society's Journal*, July 1919; "An Estimate of the Capital Wealth of the United Kingdom in Private Hands", *Economic Journal*, September 1918.

² *L'ammontare et la composizione della ricchezza delle nazioni*, 1914.

³ *Private Wealth of Australia and its Growth*, Melbourne, 1918.

⁴ *Deutschlands Volkswohlstand*, 1888-1913, 1913, and 1915.

⁵ *Richesse privée et finances françaises de l'avant guerre à l'après guerre*, Paris, 1919.

⁶ *La Fortune publique de la France*, Paris, 1911; *Les Problèmes économiques de la guerre*, Paris, 1916; "La Fortune publique de la France" (*L'Économiste européen*, February 22, 1918).

⁷ Annex 12 B, Treaty of Peace. The first committee of experts on German Reparation, presided over by General Dawes, stipulated that Germany should pay for 1929-30 and following years a sum in addition to the standard payment according to the prosperity of Germany. To measure this prosperity various factors, such as the total of German imports and exports, the total of budget receipts and expenditure taken together (after deducting from both sides the amount of the Peace Treaty payments included in the year), railroad traffic as measured by the statistics of weight carried, the total money value of the consumption of sugar, tobacco, beer, and alcohol within Germany, the total population of Germany, and the consumption of coal *per capita*, are to be taken into account.

whether the whole scheme of taxation, central, provincial and local, is equitable and in accordance with economic principles, and if not in what respects it is defective".¹ Two years previously *i.e.* in 1922, a Committee was appointed to inquire into taxation in the Dominion of New Zealand, and recently in Australia a Royal Commission on Taxation has submitted its report in five volumes. Since 1914 the development of the theory of taxable capacity has made enormous strides, and the question of the ability of various nations to bear their respective tax burdens is a very pressing one.

2. THE INCREASE IN TAXATION

The growth of taxation has been due mainly to three factors : (1) Interest charges on war debts. The necessity for reducing this burden has led to further taxation. The War was financed mainly by borrowings, although in the United States, Great Britain, and Japan taxation was greatly increased to meet the usual peace budget and war interest charges from ordinary revenue. In view of Japan's limited participation in the War no great effort of a fiscal nature was necessary, but Great Britain and the United States courageously appealed to the country to pay heavier taxes for a national cause. It was not difficult for Great Britain to increase her tax revenue, for she was rich and had a flexible income-tax system ready at hand. The United States of America increased her tax revenue by the imposition of new taxes such as the Federal income tax as well as by the enhancement of the old. (2) The extension of the functions of the State, especially in regard to education and other social services; and (3) the increase in the general level of prices.

The increase in the tax revenue of the chief countries is seen in the detailed table No. XIX., App. This is given below in summary form. In this table statistics have been gone into very carefully and include as far as possible Central or Federal, provincial or State as well as local taxation. Tax revenue only has been included, and not the total State revenue. It will be seen that, except for India and France, taxation has increased more than wholesale prices, and has also increased in all these countries in the table more than the cost of living.

¹ For complete terms of reference *vide* Preface.

THE INCREASE OF TAXATION .

Country.	Year.	Increase per cent over 1913-14 in		
		Taxation.	Wholesale Prices (Official Index).	Cost of Living (Official Index).
United Kingdom . . .	1923-24	258	59	74
India	1921-22	74	85	63
Canada	1921-22	144	65	47
Australia	1921-22	195	65	42
New Zealand	1922-23	143	75	45
United States	1921-22	195	53	68
France	1923	293	319	231
Japan	1921-22	132	93	..

3. *PER CAPITA* TAXATION

The *per capita* taxation obtaining in various countries is one method of showing tax burdens. It gives perhaps a better idea of the relative burdens than the volume of taxation itself,¹ as the latter ignores the population over which the taxation is spread.

PER CAPITA TAXATION

Country.	Taxation per Head.				
	Pre-War Year 1913-14.		Year.	Post-War Year.	
	All Taxation (Federal, State, Local).	Excluding Local Taxation.		All Taxation.	Excluding Local Taxation.
	£ s.	£ s.		£ s.	£ s.
United Kingdom . . .	5 11	3 11	1923-24	20 1	15 18
India	0 5	0 5	1921-22	0 8	0 7
Canada	5 9	4 1	1921-22	11 5	8 10
Australia	5 12	4 14	1921-22	14 8	12 4
South Africa	1 18	1 14	1922-23	4 9	4 2
New Zealand	8 17	5 10	1922-23	14 8	12 8
United States	4 6	2 0	1921-22	13 12	8 12
France	4 14	3 7	1923	7 8	5 18
Japan	1 2	0 15	1921-22	2 9	1 11
Germany*	1 11	1 11	1924-25	4 1	4 1

* State and local not included.

¹ *Vide* Table XX., App.

At the same time international comparisons require to be used with caution owing to differences in national wealth, financial systems, and social and economic structure of the countries compared. The preceding table summarises the detailed table, and gives the taxation per head in the pre-War year including and excluding local taxation, and also in the post-War year. In Germany it has not been possible to include State and local taxation. In other countries State and local taxes have been included as well as Federal or Central. Great Britain leads with a *per capita* taxation of over £20. Australia and New Zealand come next with £14:8s. per head. The United States has a *per capita* taxation of £13:12s. India has the lowest with 8 shillings per head in 1921-22. Japan is the last but one with a *per capita* taxation of £2:9s. When local taxation is included the order of these countries is not affected.

4. DISTRIBUTION OF DIRECT AND INDIRECT TAXATION

Another method of estimating the burden of taxation is to look to the distribution of taxation of direct and indirect taxes.¹ The real burden cannot be discussed without examining what the

DIRECT AND INDIRECT TAXATION

Countries.	Proportion of			
	Direct Taxes.		Indirect Taxes.	
	Pre-War.	Post-War.	Pre-War.	Post-War.
United Kingdom . . .	47·8	59·7	52·2	40·3
India (Central and Provincial)	46·9	45·0	53·1	55·0
Canada (Dominion and Provinces) . . .	8·6	56·0	91·4	44·0
Australia (Commonwealth and States) . . .	9·6	50·8	90·4	49·2
New Zealand	40·7	57·0	59·3	43·0
Japan	28·4	41·2	71·6	58·8
France	39·5	28·8	60·5	71·2
Italy	31·7	24·5	68·3	75·5
United States (Federal) .	11·0	69·4	89·0	30·6

¹ See also Chapter XXV. p. 344.

taxes are and in what proportion they are a definite burden upon individuals. This may seem a self-evident proposition, but in inquiries of this sort it is not always so obvious. What are the direct taxes and what are the indirect taxes, and what is the proportion of direct taxes such as those on income, successions, or inheritance, etc., to indirect taxes? The preceding figures show the direct and indirect taxation before and after the War in the chief industrial countries. The figures have been compiled with care from the budgets of these countries. Taxation figures only and not total revenue figures have, of course, been included.

5. PERCENTAGE OF TAXATION TO NATIONAL INCOME

It is now recognised that the best method is to consider the proportion of the total national income of each country taken in taxation. This gets over much, but not all, of the difficulty arising from differences of wealth, population, social and economic conditions. This method of obtaining an approximate idea of the ability of various countries to bear their respective tax burdens is not scientifically exact, for it should be remembered that poor countries like some of the Balkan States or Turkey would find it much more difficult to pay taxes amounting to 15 or 20 per cent than a rich country would experience in paying 25, 30, or more per cent. Moreover, one has also to consider other indications, such as the ability of a country to make payments abroad as France did in the early part of 1924 without producing chaos in exchange and in price levels. To arrive at national income the value of the commodities produced and the services performed which are exchanged for money are totalled for a twelvemonth. Care must be taken to avoid duplication as far as practicable in adding up wages, salaries, rents, profits, remuneration for risk, and all other services, etc., which in general contribute to the income of an individual. In Chapter XV. the question of calculating national income has already been discussed. It will be seen that the services of those who are not engaged in material production are included, since these contribute to what Stamp calls the national "heap",¹ and they have a claim upon produce or goods and services. Each one of us makes goods or performs

¹ *Wealth and Taxable Capacity*, p. 43.

services to sell, and it is this supply which represents the demand for the goods or services of others. The income which is obtained in a twelvemonth is the price received for the contribution to this heap or pond of goods and services in the same period, a heap or pond, as it were, which is ever changing. In calculating the national income we are not concerned with whether the income consists mostly of products from industry (as in Great Britain) or from agricultural produce (as in India), or whether a considerable part of it is made up of the value of services. We evaluate all services in general exchange for money. It is true that duplication does in many cases arise, but with the progress of statistics, especially in regard to the income tax in the present century, duplication is much less than hitherto. Interest on internal debt may form a part of the national income if we consider income from the standpoint of the Income Tax Commissioners. If, as defined above, income is the sum total of goods and services, this interest cannot be said to be in the same sense part of the national income. It embodies no new services or commodities, but is a mere transference from one set of people to another. It is subject to taxation, and has been included for the present purpose of comparing the tax burdens of various countries. The two methods usually followed are: (1) to add, as we have seen, incomes of individuals, avoiding mere transferences as in the case of allowances to sons, doles to unemployed, and old age pensions as paid in Great Britain; and (2) to find the value of the commodities produced and to supplement this wherever necessary. The former method is possible in advanced countries like Great Britain and the United States, while the latter is necessary in cases where income-tax statistics are not available in sufficient detail and comprehensiveness as in India. The income-tax statistics in the former case are supplemented by statistics of wages for incomes below the exemption limit. Stamp and Bowley in Great Britain and Helfferich in Germany have supplemented income-tax statistics in this way. Pupin in his book¹ divides the national income into income from capital and income from work, and estimates each separately. Under income from work he includes statistics of wages and salaries. In using statistics of wages very great care must be taken in order to avoid large errors in the result, and therefore comprehensive

¹ *La Richesse de la France.*

wage statistics are necessary. Some writers, such as King,¹ arrive at national income by valuing the production of the country as well as by multiplying the book income of families by the number of families in the class and adding up the whole. Other writers, such as Théry,² estimate from death-duty statistics the national income by calculating what is the principal income from the different classes of property. The transfers of property by death or by gift are reported for tax purposes, and these are assumed to be one-fourth of the national income. Other writers build up their estimates by an analysis of the total wages bill, the revenue from property, industrial and agricultural profits and earnings. It is also possible to check these estimates by various statistics, as, for instance, the total national savings (*i.e.* net investments in shares, debentures, securities, etc.), long-term savings, import figures, and the currency in circulation. It is, for example, estimated that the national income before the War in France was one-fifth of the imports, and from this it is assumed that the figures represent the same proportion to-day as they did before the War. Similarly with circulation which is known it is assumed that circulation bears to the income the same proportion now as it did before the War. These, however, are very rough checks and are not to be relied on in view of other scientific and more accurate estimates that are available. In regard to Germany, if Central Budget figures only are given, it must be remembered that the Central Budget since 1918 carries sums formerly paid by the separate states of the Empire.

The results in Table No. XXII. are summarised in the table below, which shows the tax revenue (not total revenue) in proportion to the total national income including and excluding local taxation. One lesson from the data is that Great Britain is not the only nation that is burdened with heavy taxation. Taxation, it will be seen, in Great Britain, Germany, Australia, and Canada is at the moment considerably higher than in other countries. The figure for France is, in view of its wealth, comparatively low. The figure for India in the neighbourhood of 5 per cent will not surprise those who have studied in detail the productive capacity of the country at the present time. The burden of taxation, as

¹ *The Wealth and Income of the People of the United States, 1922* (Macmillan, New York).

² *La Fortune publique de la France, Paris, 1911.*

• TAXATION AND NATIONAL INCOME

Country.	Proportion of Taxation to National Income in				
	Pre-War Year 1913-14.		Year.	Post-War Year.	
	All Taxation.	Excluding Local Taxation.		All Taxation.	Excluding Local Taxation.
United Kingdom	11.4	7.3	1923-24	23.5	18.4
India	4.4	4.0	1921-22	5.1	4.7
Canada	13.0	9.7	1921-22	19.2	14.6
Australia	10.4	8.9	1921-22	18.4	15.7
United States	6.5	2.9	1921-22	9.0	5.7
France	13.8	10.2	1923	14.2	11.3
Germany . . . . .	..	..	1924-25	..	18.3*
Japan	18.2	12.6	1921-22	21.8	13.7
Italy . . . . .	..	8.6	1922-23	..	5.8

* Estimates only, see Table XXII., App.

has been shown, depends also on the standard of living or the productive capacity of a country's inhabitants, the method by which taxation is levied, the purpose for which taxation is used, and also the mentality of the people taxed. It should be remembered that over 70 per cent of the population in India and 60 per cent in Japan are engaged in agriculture. Agricultural countries cannot, and do not, produce the wealth of countries predominantly industrial. Progressive taxation is less burdensome to the lower income groups than proportionate taxation on all incomes whatever their size. Interest charges paid within the country are a mere transference of funds, and therefore do not constitute a heavy burden on the country as a whole. In an hour of patriotism more may be subscribed than in a generation of lethargy, and with less real effect on the population of the country.

When one country's taxation is compared with another or one portion of a country with that of another, there are some factors which may account for a higher burden of taxation. Among these may be mentioned area, density of population, cost of living, and the rate of wages. The cost of collection of land taxation may be high on account of the area covered by the staff collecting that revenue. Police expenditure and the administration of justice depend, among other things, on the density of population. One part of a country may be more expensive to

live in than another. Expenditure will be higher and so the taxation to meet that expenditure. Where there are, as in a centre of industry, other employments available, wages may be high, with the result that expenditure and taxation on the part of the State may also be high.

CHAPTER XXX

NON-TAX REVENUE

1. THE revenue of States includes, in addition to the revenue from taxation, income from public property and public undertakings. In most countries, as will be seen from the following table, this is as follows :

Country.*	Year.	Percentage of Non-tax Revenue to Total Ordinary Revenue.
Great Britain . . .	1923-24	14.1
Canada†	1921-22	23.2
Australia† . . .	1922-23	55.0
New Zealand . . .	1922-23	43.5
South Africa† . . .	1921-22	33.8
India†	1921-22	33.3
United States‡ . .	1921-22	21.8
France	1923	11.4
Italy	1922-23	54.0
Japan	1921-22	32.0

* The percentages do not include Government monopolies, such as those in France, Italy, India, and Japan.

† Federal or Central and State or Provincial.

‡ Federal only.

In the revenue accounts or exchequer receipts of Great Britain the non-tax revenue includes receipts from the postal, telegraph, and telephone services, from crown lands, from interest on Suez Canal shares, etc., and administrative receipts by civil departments. The receipts are either ordinary or special. The special receipts cannot continue indefinitely, being mainly from the sale of War assets and reparations. Thus in 1922-23 the Disposals and Liquidation Commission paid to the Exchequer nearly £17 millions for the sale of surplus Government property and

£10 millions for the sale of raw material. The Treasury also realised £14½ millions, which included £6 millions for repayments connected with advances in respect of premortgage bills, £1,388,400 of gold salvaged from the *Laurentic*, £4½ millions for receipts under the German Reparation (Recovery) Act 1921, and £2,300,000 received in cash from the Reparation Commission. In 1923-24, it is interesting to note, the Budget estimates were £837,000,000 of revenue, of which £718,000,000 was tax, and £119,000,000, or 14·1 per cent, non-tax revenue. In India two-thirds of the Central and Provincial receipts combined are tax revenue, and the remainder is income from Government undertakings, such as railways, irrigation, other public works, posts and telegraphs, forests, the mints at Calcutta and Bombay, receipts in connection with civil departments, and interest on loans. The revenue from these heads is given in the following table :

	Non-tax Revenue, Percentage to Total Revenue.			
	Fifty Years Ago, 1871-72.	Twenty Years Ago, 1901-2.	Pre-War Year, 1913-14.	1921-22.
Government or public undertakings	5·0	27·5	34·3	22·9
Receipts from social services . . . . .	..	0·3	0·4	0·4
Others (including interest on loans).	5·6	4·6	4·9	10·0
Total	10·6	32·4	39·6	33·3

In the United States ordinary Federal receipts in 1924 were budgeted as \$3362 millions, of which \$512 millions or 15·2 per cent were non-tax. Postal revenues are excluded from these ordinary receipts. The French Budget amounted in 1922 to Fr.23,381 millions, of which State domains yielded Fr.183 millions, posts Fr.1086 millions, and miscellaneous non-tax Fr.5307 millions. The Italian Budget estimates for 1923 show, out of a revenue of over 12 thousand million lire, only 15½ millions as receipts from real State property, and 550 millions from postal, telegraph, and telephone services. The Swedish Budget includes as non-tax revenue receipts from posts and telegraphs, waterfall works, railways, domains, interest on shares in certain companies,

e.g., the Swedish Tobacco Monopoly Co., Ltd., the Central Liquor Co., Ltd., and also a share in the profits of the Bank of Sweden. Similarly Holland includes the revenue derived from domains, State railways, the sum paid by the East Indies as interest and sinking fund for public debt, and the share in the profits of the Bank of the Netherlands, as well as certain other miscellaneous receipts. Japan in 1923, out of an ordinary revenue of 1245 million yen, budgeted for 734 million yen from taxation, and of the remainder (non-tax revenue) over 348 million yen was from public undertakings and State property.

2. It will be seen that in modern governments State enterprise and domains are not a negligible source of revenue. The importance differs from country to country and according to local conditions. The State as a capitalist and *entrepreneur* is, usually, at no small disadvantage, but it is the fashion from the time of Adam Smith to exaggerate its incapacity to conduct industrial enterprise. "No two characters", wrote Adam Smith¹ in 1776, "seem more inconsistent than those of trader and sovereign. If the trading spirit of the English East India Company renders them very bad sovereigns, the spirit of sovereignty seems to have rendered them equally bad traders. While they were traders only, they managed their trade successfully, and were able to pay from their profits a moderate dividend to the proprietors of their stock. Since they became sovereigns, with a revenue which, it is said, was originally more than three millions sterling, they have been obliged to beg the extraordinary assistance of Government in order to avoid immediate bankruptcy. In their former situation their servants in India considered themselves as the clerks of merchants; in their present situation those servants consider themselves as the ministers of sovereigns." While he realised the advantages of State banks as a source of revenue, he wrote, "The orderly, vigilant, and parsimonious administration of such aristocracies as those of Venice and Amsterdam is extremely proper, it appears from experience, for the management of a mercantile project of this kind. But whether such a Government as that of England, which, whatever may be its virtues, has never been famous for good economy, which, in time of peace, has generally conducted itself with the slothful and negligent profusion that is perhaps natural to

¹ *Wealth of Nations*, Bk. V. chap. ii. part i.

monarchies, and in time of war has constantly acted with all the thoughtless extravagance that democracies are apt to fall into, could be safely trusted with the management of such a project, must at least be a good deal more doubtful," and he adds, with reference to the post office, that "it is perhaps the only mercantile project which has been successfully managed by, I believe, every sort of Government. The capital to be advanced is not very considerable. There is no mystery in the business. The returns are not only certain, but immediate."¹

Some of the reasons why the author of *The Wealth of Nations* supports Government's management of the post office would equally well apply to other activities which modern States now undertake. The example of India in the sphere of irrigation, railways, and forests, of Egypt in irrigation, of Japan, France, Italy, and Germany in regard to monopolies, not to mention the remarkably successful administration before the War of railways in Prussia, may be instanced. An efficient corps of officials, like that of Prussia, is certainly not unknown in other countries of the world. The spread of education of a high type and the growth of the influence of universities with old traditions are having an incalculable effect on the younger men of all the chief industrial countries. Men of sterling character, able to produce as civil servants work of meticulous accuracy and finish, are the products of our schools and universities. The experience, therefore, of State enterprise in the twentieth century is on the whole against the disparaging criticisms of Adam Smith.² It is, as we shall see, frequently necessary, on political and on economic grounds, for public authorities to undertake functions of an industrial and commercial nature. It is not always the case that production suffers from public ownership. Indeed it was urged before the British Coal Commission of 1919 that nationalisation of the coal mines would lead to increased production.

THE PUBLIC DOMAIN—LAND AND FORESTS

3. In the early history of modern States the royal domain was the basis of the public revenue. With the growth of time

¹ *Op. cit.*, *idem*.

² Cf. Leroy-Beaulieu, *Traité de la science des finances*, chap. ii. (De l'importance des revenus de l'état moderne considéré comme propriétaire ou capitaliste et comme industriel); also chapters iii.-vi. Paris (Guillaumin), 1879.

and the progress of society land as a source of revenue declines. When, for example, William the Conqueror arrived from Normandy he found that the Anglo-Saxon kings "had enjoyed great landed possessions, and flocks and herds. They had possessed rude castles, jewels, and richly embroidered robes of state. They had had a royal hoard kept in the king's castle, where there were leather bags filled with the roughly minted silver coins of the time."¹ The Norman kings claimed the royal demesne with the forests, the land held by the rural tenants and the holdings of urban tenants in cities and boroughs founded on folklands, from which the sheriffs collected rents. With successful wars the royal lands grew. They grew too through resumption by the king. They decreased mainly through expensive wars, which had to be financed, and through their bestowal on favourites. Thorold Rogers mentions how in the fifteenth century, in England, land belonging to the Crown was squandered away. In France the king similarly lost his estates, but here a large amount fell into the possession of the communes. Space will not permit an account of the continual alienation and resumption of the State lands in Western Europe as, for example, during the period of the Tudors and the Stuarts. During the reign of William and Mary the royal domain greatly decreased. "At the end of William's reign", as Sir Erskine May puts it, "Parliament having obtained accounts of the state of the land revenues, found that they had been reduced by grants, alienations, incumbrances, reversions, and pensions, until they scarcely exceeded the rent-roll of a squire." It was from this time impossible to look to anything but taxation for the carrying on of the State. To-day State lands are, as in France, Italy, and Spain, of little importance from the revenue point of view. In the most recent budgets available the percentage of ordinary revenue from State domains is 1·3 per cent in Great Britain, 0·9 per cent in France, 0·1 per cent in Italy, and 0·9 per cent in Spain. In Russia before the Revolution of 1917 there were very large State domains and forests. There were also large estates held by private individuals. By the Constitution of 19th July 1918² private property in land is no

¹ Fisk, *English Public Finance*, New York (Bankers' Trust Company Publications), 1920.

² Amended 1919-1922.

longer permitted. Land, forests, mines, factories, and railways are national property. The "new economic policy" (March 1921) has modified the law and permitted the leasing of nationalised industries, and the concentration of State control on the most important of the nationalised enterprises. No up-to-date financial statistics are available to show the effect of this policy on non-tax revenue, especially on landed estates including forests.

In India the State possesses in theory, except in the permanently settled tracts, a right to the land. It has never given up this right, a right inherited long before the days of pre-British rule. We have, however, dealt with this in Chapter XX. on land taxation. The system of assessment and of collection has already been described. Under the new Constitution land revenue is a provincial (and not a Central) head of revenue. In the financial year ended 1922, land revenue was Rs.35½ crores (£23½ millions) or 42·5 per cent of the total provincial revenue of the various Governments. Forest revenue, also a provincial head of revenue, was Rs.6 crores (£4 millions) or 8 per cent of the total provincial revenues. The total forest area in India covers more than a quarter of a million square miles, and only about 61,000 square miles of this has been brought under regular scientific management. It is often forgotten how much wealth proper afforestation brings to a country. Next to the discovery of root crops by which live stock was kept over the winter, and not killed off, nothing has brought such an accession of wealth to Scotland as the afforestation, especially of the eighteenth century. Deforestation in India had probably been going on for hundreds of years, until, in the nineteenth century, a Forest Department was set up. By the destruction of trees water is no longer stored and doled out gradually, with the result that the vegetation and surface soil are swept away. On the other hand, the absence of wood for fuel has resulted in animal dung being burnt as fuel instead of being used as manure to fertilise the land.

In new countries where capital and labour are scarce, land is sold by the State as an incentive to immigration. These lands if sold should, as Wakefield pointed out in the thirties of last century, not be granted promiscuously but sold at an adequate price and in a regular fashion, and the proceeds should

go to assist further immigration.¹ The interests of the settlers in the United States, Australia, New Zealand, as well as in Canada, were those which shaped land policy in these countries during the nineteenth century. In the United States as early as 1775, one year before the publication of *The Wealth of Nations*, it was decided by wise statesmen to set aside part of this great source of wealth for the development of education. In each township Section No. 16 (i.e. 640 acres or one-thirty-sixth of the area) was reserved for the support of schools. From 1848 Section No. 36 was also granted for public (or high) school purposes. Thus one-eighteenth of the area of each township in every State of the Union was reserved for education. In 1787 it was provided that not less than two townships of land were to be granted in each State for the support of a State University by the Federal Government, and in 1866 for agricultural and industrial education an amount equal to 30,000 acres for each senator and representative was granted to each State, and it is on this that agricultural colleges largely depend for their funds. No Federal Government could have tried to do its duty more fully than that of the United States in this respect, but this is not to be wondered at in view of the great names like those of Thomas Jefferson, John Adams, and George Washington, associated with the early history of this great Republic. The sales of land in the Federal Budget of the United States are credited as income, and in 1922, 1923, and 1924 were only \$2,220,000 out of \$10,896 millions of ordinary receipts.

THE PUBLIC DOMAIN IN COMMERCE AND INDUSTRY

4. Another class of non-tax revenue is that which is derived from the commercial and industrial activities of the State. Some writers term this branch as the industrial domain, but this hardly covers activities outside industries, such as transportation. Leroy-Beaulieu² more appositely, though not quite

¹ House of Commons Paper 512, 1836; cf. Mill, *Principles*, V. xi. § 14; cf. Wakefield's *England and America* (1833).

² *De la science des finances*, chap. vi. p. 88, "L'État a quelquefois un domaine industriel et même un domaine financier, par exemple des participations dans des banques ou même un portefeuille de valeurs mobilières. La Prusse est le plus frappant exemple de cette organisation."

correctly, calls this "the industrial and financial domain of the State", since it covers, for example, the profits accruing to a State which possesses a State bank. The public domain in commerce and industry includes mines; factories (*e.g.* arsenals) which are not primarily for revenue purposes; public works, such as irrigation, drainage, water and lighting, and posts, telegraphs and telephones, roads, canals, and railways.

5. From early times mines have been public property, as, for example, the silver mines of Laurium in Athenian history, and gold, silver, and salt mines in the history of Rome, gold and silver being worked directly by the State slaves. Until 1688 in England all mines yielding gold or silver were the property of the Crown. In the fourteenth and fifteenth centuries charters were granted to prospectors to enter upon private lands to search for ores. The rights of the lords or seigneurs were respected to the extent that the mining charters prohibited without a licence from the overlords mining under houses, sometimes under arable lands and meadows. A double royalty was thus imposed. In the time of Edward IV. a lease of copper mines reserved a royalty of one-eighth to the king and one-sixteenth to the landlords. In 1688¹ a great change took place in the law. An act was passed that no mine of copper, tin, iron, or lead shall hereafter be adjudged, reputed, or taken to be a royal mine although gold or silver may be extracted out of same. By an act of 1693² the act of 1688 was modified, the Crown being given the right of pre-emption of the metal at such price as would represent its fair value in the absence of royal metals. In the case of a mine worked for gold the prerogative of the Crown was, it is interesting to note, confirmed by the Court of Appeal in England as late as 1891. Roscher points out that in Germany there was a system of free mining, where the land could be opened up notwithstanding a protest from the landowner if royalties were paid to the State. In some countries much of the mineral wealth was held to be public property. Prussia is a case in point.

The position to-day in most countries is for mines to be handed over to private enterprise for development as far as possible, including those which possess a natural monopoly. There is a great deal in what Adams says regarding financial policy and mines. "Mines", he points out, "that are widely spread

¹ 1 Will. and M. c. 30.

² 5 Will. and M. c. 6.

and easily discovered may be treated like the property of ordinary industries. No special financial policy is required for minerals like coal, iron, or salt. Mines, on the other hand, which form the basis of a natural monopoly should be handed over to private enterprise for development, but they should, at the same time, be recognised as a fit object for special and peculiar taxation.”¹

6. States have sometimes to undertake the manufacture of goods when this cannot be satisfactorily done within the country itself. In India, for example, there are arsenals which manufacture munitions. Army clothing, however, is manufactured by private firms, such as those in Bombay and Cawnpore, and purchased by the Army Department. In some countries the State itself manufactures the goods, as it believes, usually wrongly, that private contractors are unable to undertake the work without undue costs in regard to supervision. Where industry is unable to produce the wants of the State it is necessary to keep these State concerns going. They have the advantage of sometimes preventing prices from rising, but public authorities should not undertake such industries, except in the earlier stages of development, and then mainly for experimental purposes, and also where the establishment of a monopoly is ostensibly advantageous. An important point in such concerns is the keeping of strictly commercial accounts. Interest should be paid on capital. Provision should also be made for depreciation of machinery and plant, for a pension fund, rents for land, and income tax in order to arrive at the true net profit. State concerns sometimes show a surplus, but the point is how much of this is really profit? The fact that State enterprise is carried on at a loss does not necessarily prove that it should not be undertaken. It may be desirable that certain services should be performed by Government even at less than cost price, as, for example, the manufacture of vaccine or serum.

The cost of Government monopolies has been discussed in a previous chapter, since they are best treated as a part of revenue raised by taxation. Municipal trading nowadays undertakes the supply of water, drainage, and frequently lighting. Thus in the city of Bombay, with a population of 1,200,000, the Municipal Corporation undertakes the heavy task of water supply and

¹ *Science of Finance*, p. 239 (New York: Henry Holt and Company).

drainage, while a company undertakes the supply of electricity and electric tramways. In most countries, while the municipalities supply water and provide for the disposal of sewage, the question of lighting is not uniform. In brief, the position of public authorities—federal, State, or provincial or local—deserves in the domain of commerce and industry the most constant watching. Only occasionally are real profits made, *i.e.* sums paid in relief of the rates in local finance or taxation in State or federal finance.

7. A not unimportant item of revenue in some countries is irrigation. The returns on irrigation in India, for example, have been very satisfactory. At the present time the total length of canals and distributaries in operation in British India amounts to 67,000 miles, irrigating an area of 28 million acres or 14 per cent of the entire cropped area. The estimated value of the crops supplied in a year with water by Government works was approximately £113 millions, or more than double the capital expenditure on the works themselves. The total capital outlay on irrigation works was £54,000,000 and the gross revenue was £6,500,000, and the working expenses £2,500,000, so that the net return on capital was therefore 7·2 per cent.¹ Many of these irrigation works yield a much higher return, of course, than 7 or 8 per cent. This is the average of all the works. At present in Sind the Sukkur Barrage Project, the biggest of irrigation works in the world, will irrigate no less than an additional five million acres. The cost of the scheme will be approximately £12 millions.

8. Of those concerns yielding a revenue to the State, post offices, telegraphs, telephones, canals, tramways, and railways are examples. Almost without exception the post office has been regarded since Adam Smith's time as suitable for public management. In its early history it was in the hands of private individuals or privileged bodies, such as the messengers of the University of Paris. In view of the influence of the post office on other countries it will be necessary to examine its history in some detail. About the middle of the sixteenth century foreign merchants instituted a service to the Continent, which subsequently, owing to disputes among them, was placed under Government control. In 1635 it was possible to send private letters by the posts within Great Britain, and a monopoly on existing postal routes was

¹ 1921-1922.

proclaimed and made effective by cheap rates. For a single-sheet letter the charge was 2d. for 80 miles or less and 4d. up to 140 miles. Over 140 miles 6d. was charged, and 8d. to Scotland. From 1644 to 1650 Edmund Prideaux was postmaster and worked at his own cost, the postage for letters being his receipts. In 1650 he paid Government a rent of £5000 a year. In 1653 he ceased to be a postmaster, and the office was farmed for £10,000 a year. The profits from postage alone were estimated at from £14,000 to £20,000. In 1657 the first Act of Parliament regulating the post office was passed, reducing the rate beyond 80 miles to 3d. for England and 4d. for Scotland. From 1660 the post office was farmed for £21,500, and in 1663 the revenues of the post office were assigned to the Duke of York. In 1677 the Duke of York himself took the management into his own hands, and in 1685, on his accession, it became a part of the personal revenues of the Sovereign, valued at £65,000. From 1720 Ralph Allen of Bath, the precursor of Rowland Hill, developed a system of cross-country posts between the six main post-roads. A daily post on many of the main lines was also introduced by him. In 1761 his account showed a profit of £12,000. In 1837 the privilege enjoyed by Members of both Houses of Parliament of franking, which led to so much abuse, was discontinued through the efforts of Rowland Hill. As one noble lord wrote: "The loss of consequence from ceasing to be able to frank a letter for a lady or, in travelling, for the waiter at an inn, gave great disgust to many members of both Houses, and made some of them openly declare that there was no longer any use in being in Parliament".¹ It is estimated that as many as 5 million letters a year were franked by Members of both Houses of Parliament, not to mention miscellaneous packages of various sizes. In 1840 Rowland Hill's plan of a penny postage was introduced after much difficulty, together with prepayment by means of stamps. The postmen had no longer to collect on each letter the postage on delivery, an expensive business, since it is the collection and distribution of letters that run up the cost. With this reduction of cost there was an improvement in delivery. France adopted in 1848 a lower postage which was doubtless brought about by the reforms begun by Rowland Hill, and, as in England, this produced at first a decline in gross revenue.

¹ Sydney Buxton, *Finance and Politics*, vol. i. p. 1404.

In recent years the work of the post office has increased, but in most countries one is struck by the revenue produced. To-day almost all countries follow the principle of charging according to what the traffic will bear. The charge is not according to the distance or the nature of the letter, but according to the weight of the letter. In addition to the fact that rates are irrespective of distance, there are also other peculiarities regarding postal charges, viz. (1) the rates are low and (2) vary according to the classification of packages. This latter point may be said to protect the post office from being deluged with articles too large to handle with ease. The post office also remits sums of money in small amounts by telegraph as well as by post. The remittance by post is in some countries of considerable importance; the remittances by money order in the case of India in 1922-23 being 32 millions in number, valued at Rs.80 crores. There are also other functions of post offices, *e.g.* (1) the granting of postal life insurance policies, (2) savings banks, (3) the sale of cash certificates, (4) the collection of articles sent by post, (5) the sale of quinine, and (6) in some countries the payment of small pensions which is effected through post offices. Telegraphs, telephones, and wireless are the usual functions now closely allied with postal services. The telegraph was used in England as early as 1837, and in 1847 to transmit the Queen's speech to the provinces. By 1868 telegraphs had extended all over England.

The question is frequently raised whether the post office should be expected to produce a considerable revenue to the State or whether it should simply pay its way. In most countries the monopoly does not yield much revenue to the State, as will be seen below.

American writers, notably Adams, hold that "the aggregate of receipts must cover the aggregate of cost; but in the attainment of this result greater regard should be had to volume of service rendered than to the charge upon the unit of service".¹ While much is to be said for the American point of view, there is the necessity of seeing that there is certainly no loss, and in this particular we refer to the necessity of regarding the post office, including telegraphs and telephones, as a running concern. There is undoubtedly a considerable amount of capital sunk in the undertaking for which a business concern would charge interest

¹ *Science of Finance*, p. 279.

and depreciation before showing profit. Any charge beyond a small claim would be in the nature of taxation. For telegraphs a very high purchase price for the concern has been paid in many countries; and this, together with the desire on the part of the public to have low telegraph rates, has militated against successful financial results. As in the case of municipal enterprise commercial accounting must be followed, and debt charges, both for sinking fund as well as interest, should be deducted from the gross receipts in order to arrive at the net income or profit. The following table shows the net revenue of the postal, telegraph, and telephone services in certain chief countries:

NET REVENUE OF POSTAL, TELEGRAPH, AND TELEPHONE SERVICES

Country.	Year.	Post Office	Telegraphs.	Telephones.	Total.
United Kingdom (million £)	1921-22	2.3	* 3.0	* 0.6	* 1.3
India (Rs. lakhs)	1921-22	..	..	..	57†
Canada (million \$)	1920-21	1.7	1.7	7.5	10.9
New Zealand (million £)	1922-23	0.38	0.19		0.57
Australia (million £)	1921-22	..	..	..	1.5
South Africa (million £)	1921-22	0.19	..	..	..
France (million francs)	1922	..	..	..	* 239

Note * indicates deficit.

† Posts and telegraphs alone.

All the countries in the above table, except France and the United Kingdom, show a surplus.

RAILWAYS

9. The next group after posts, telegraphs, and telephones is roads, canals, tramways, and railways. The maintenance of roads is usually undertaken by local authorities, except in the case of the main arteries, which sometimes are paid for wholly or partially by the State or central authorities. Tolls, however, are now regarded as antiquated and cannot be considered to be a revenue-producing agency. The cost of upkeep with the great development of motoring is nowadays very great, and forms a large item of expenditure of local authorities in Great Britain. Canals, largely owing to the growth of railways, do not now, with rare exceptions, yield much, if any, revenue. There are, it is true,

certain canals of importance, even at the present time. The Suez Canal, 100 miles in length and built in 1869 at a cost of nearly £30 millions, produces revenue to the British Government and other shareholders. The income during 1921-22 was £13·8 millions to the British Exchequer. The Manchester Shipping Canal (which cost less than half the Suez Canal) was open to traffic in 1894, and for the year ending December 1922 the revenue was £792,800 on a paid-up capital of £17,423,000 or 4·6 per cent. The total length of canals in England and Wales is 3641 miles and 184 miles in Scotland. On the whole they do not pay their way, and this is not peculiar to Great Britain but is found in Germany and in the State of New York. In France canal dues were abolished 44 years ago.

Tramways are usually, but not always, worked by local authorities. At the end of December 1919 there were in Great Britain 2728 miles, of which 1754 miles were worked by local authorities and 974 miles by companies. The net receipts were £6,884,000, the total paid-up capital being over £79 millions, showing a return of 8·7 per cent on the capital. In some centres of large population, as in London, tramways in recent years have not been able to compete with private bus companies. Tramways have usually to bear part of the upkeep of roads. In the last accounts of the London County Council there is a charge, for example, of £269,500 per annum in the tramways accounts for maintenance of the road service which the Borough Councils would have had to meet if there were no tramway system. Tramways are, in these circumstances, sometimes unable to pay a suitably high rate of wages.

Next, with regard to railways. The importance of this domain may be seen from the fact that the mileage of the world's railways is to-day over 660,000 miles, of which approximately one half is in America and one-third in Europe. America and Europe account for a total of five-sixths of the mileage or 85 per cent. Of the remaining 15 per cent, 8 per cent is in Asia, $3\frac{1}{2}$ per cent in Australia, and $3\frac{1}{2}$ per cent in Africa. A great authority estimated at the end of last century that railways probably represented one-tenth of the total wealth of the civilised nations, and one-fourth, if not one-third, of their total invested capital, an amount much higher than any other important undertaking.¹ To-day the

¹ Hadley, *The Railways of America*, London, 1890.

railway density, *i.e.* the number of miles of railway per 100 square miles, is greatest in Belgium and lowest in Persia. Great Britain, Holland, and France are far behind in this respect. In railway mileage per 10,000 inhabitants Australia (Queensland) holds the premier position, followed by Canada, New Zealand, the Argentine, and the United States. In this Persia again holds the record for isolation. The capital invested is over £9000 millions, divided evenly between Europe and the rest of the world. The United States on account of its great mileage (264,000) has the largest amount of capital, over £4000 millions. The capital cost on a route mileage basis is greater in Great Britain than in other countries because of the high standards of the original builders and of the Board of Trade's safety requirements. This, together with the fact that many of the lines are double or treble, accounts for the comparatively high cost. The route mileage capital is also high in Holland, Belgium, France, and Italy. The financial results of railways in various countries are set out in the following table :

Country.	Year.	Capital. (000,000)	Working Expenses. (000,000)	Net * Earnings. (000,000)	Percentage to Capital of	
					Working Expenses.	Net Earnings.
United Kingdom	1920	£1328	£262	£53	19·7	4·0
India . . .	1922-23	Rs.6690	Rs.730	Rs.330	10·9	4·9
Canada . . .	1920	\$2341	\$515	\$24	22·0	1·0
Australia . . .	1921-22	£251	£30	£8	12·1	3·4
New Zealand . .	1922-23	£40	£5·5	£1·2	13·6	3·0
Union of South Africa . . .	1922	£105	£21	£2·5	20·1	2·4
U.S.A. . . .	1922	\$22,300	\$4500	\$1100	20·0	5·2
Japan	1920	Y.1188	Y.271	Y.78	22·8	6·5

* After deducting from the gross earnings working expenses only.

There are only a few countries in which railways are privately owned, the most important being the United States (264,000 miles) Great Britain (20,000) miles, and Spain (10,000 miles). In most countries railways are owned by the State, and worked either by the State or by the State and private companies.

The question of State or private ownership does not make any considerable difference in the system of rate making adopted by an efficient railway. A State railway arranges its rates to pay

THE STATE DOMAIN—RAILWAYS •

I. *State operated*

	Miles.		Miles.
Russia	43,000	Rumania	7,000
India	37,000	Belgium	5,000
Germany	36,000	Switzerland	4,000
Australia	24,000	Austria	4,000
Mexico	11,000	Denmark	3,000
Italy	10,000	New Zealand	3,000
Poland	10,000	Norway	2,000
Union of South Africa	10,000		

Total (15 countries) = 209,000 miles.

II. *State and privately operated*

	Miles.		Miles.
Canada	40,000	Japan	8,000
France	26,000	China	7,000
Argentina	22,000	Chile	5,000
Brazil	17,000	Hungary	4,000
Sweden	9,000	Holland	2,000

Total (10 countries) = 140,000 miles.

interest on its capital just as a private company has to do. In theory the operating of railways by the State has much to commend itself, but the question is one which can be argued only after an examination of local conditions. Where the officials are as intelligent and as energetic as those in private companies, and able to act in the interest of the public to the same degree, the monopoly which the Government enjoys will not be abused. In fact it may be otherwise. "The question", says Hadley, "is one which practical railwaymen have long since ceased to argue on general principles; they recognise that the answer depends upon the respective degree of talent and integrity which characterises the business community on the one hand and the Government officials on the other."

The Acworth Committee on Indian Railways, while favouring State operation for India, set out the case thus: "An important and weighty section of opinion, including that of the Railway Board, is opposed to the view that State management is the best, holding that, as railways are primarily commercial undertakings, they should be managed on a commercial basis, so as to secure economy and efficiency, that is to say, by a company with a Board of Directors. The following are held by the same body of opinion to be some of the defects in State management: (1) Constant

transfers of senior officials, resulting in lack of continuity of policy ; (2) the tendency to give promotion on the grounds of seniority alone without sufficient regard to efficiency or local knowledge ; (3) disregard of public opinion ; and (4) lack of initiative and flexibility. Further, as regards the co-existence of company-managed railways and State railways, it is urged that improvements in the administration of State railways, which have been effected during past years, are mainly due to the emulation inspired by company management ; in other words, that the initiative lies with the company-managed railways, and that emulation and comparison provide healthy results in the case of State-worked lines.”¹ The case for State management was expressed as follows : “ A large section of the Indian public supports the adoption of this system, because it believes that company management does not encourage the development of indigenous industries by sufficiently favourable treatment ; that it gives preferential treatment to import and export goods ; that under the present system of company management large profits are made in British interests ; and that hitherto the companies have not employed Indians in higher appointments except to a very limited extent, and have not granted them adequate facilities for technical training. Without pausing to argue here whether these views are correct or not, we venture to think they are coloured by the impression that company management necessarily connotes management through Boards in London. This, however, is not an essential condition of company management in India.”² In India it may be noted that the State generally owns the lines, and the lines are worked either by State or (a) guaranteed and (b) independent companies. The State lines comprise more than two-thirds of the combined total lines of British India and Native States.

The Prussian railways were for long regarded as probably the best-operated State railways in the world.³ The yield of railways in other states of the German Reich did not yield a large return. From 1st April 1920 the various State railways, including those of Prussia, have been transferred to the Federal Government. In

¹ Cmd. 1512 of 1921, paragraph 254.

² Cmd. 1512, 1921, paragraph 255.

³ Cf. *The Economic Development of France and Germany*, J. H. Capham (Cambridge University Press, 1921).

France by the law of July 1842 the construction of railways was left mainly to companies, but are subject to control by Government authorities with regard to the method of operation. This control is said by impartial authorities to deaden the activity of the companies. The State works one of the seven important systems. The concessions granted to the other six companies expire on various dates from 1950 to 1960. Of the other railways, namely Russia, India, Australia, Mexico, Italy, Holland, the Union of South Africa, Rumania, Poland, New Zealand, and Norway, the one generalisation that may be made is that the return on the capital has not been high. In 1909 in Mexico the main railway lines were united in one corporation—the National Railways of Mexico. Since 1914 this system, and practically all the private lines, have been taken over by Government. In 1910 the Government lines of the Union of South Africa were merged into one system—the South African Railways, under the control of the Union Government. In Belgium in 1919 there were 2759 miles belonging to the State excluding light railways, and private lines were 184 miles. In Hungary of 4493 miles of railways 1856 are owned by the State. In Switzerland in 1920 the State railways had a length of 3881 miles, and in Austria 2964 miles out of 4274 were operated by the State. About half of the single track in Canada is owned by the State under the name of the Canadian National Railways. In the Argentine 18 per cent of the railway mileage belongs to the State. Many of the railways in the Argentine have been constructed with the aid of British capital. In Brazil of the total mileage which belongs to the State 3980 were administered directly and the rest were farmed out. In Holland all railways are private. There is, however, one State company, but this is only so because the road is owned by the State.

Speaking generally, then, it may be said that in most countries the railways are owned by the State, and with the exception of the United States, Great Britain, and Spain are either (a) State operated or (b) operated by the State and by private companies with a varying degree of State supervision. There are very few countries in the world where State supervision is confined mainly as in England to the interests of public safety. In England the free system of railway building and management has resulted in progressive methods which have been copied in many other

countries. At the same time there is the disadvantage that the public may be inadequately protected because the courts are unwilling to interfere, although in recent years, both in Great Britain and in the United States, there has been an increase in legislative interference with railways.

In railway finance rates are not determined by free competition. This does not and cannot exist as this is not to the interest either of the companies or of the public. It produces an uncertainty with regard to rates which prevents stable prices; it assists unscrupulous agreements between competing lines with regard to rates by pooling or dividing the traffic, and the rates are made not on the principle of equal mileage, *i.e.* the rates proportionate to the distance, but according to movement expenses and terminal expenses, *i.e.* freight pays its share of the terminal expenses independently of the distance and the mileage charged according to the length of haul. Rates are reduced where the increase of business makes it profitable, or kept high where such a low charge would be unprofitable or where business is not expanding. The theory of charging according to what the traffic will bear is, as Hadley points out, "an unpopular one because it has been misapplied by railway managers and made an excuse for charging what the traffic will not bear. Rightly applied, however, it is the only sound economic principle. It means taxation according to ability—that ability being determined by actual experiment."

There are two other important points which demand attention in the public domain of railways, and these are (1) the scheme of fixing rates in order to pay a suitable return on capital as fixed by the well-known American Act—the Transportation (Esch-Cummins) Act of 1920 amending the original (1887) Act to Regulate Commerce, and (2) the separation of the railway Budget from the general Budget.

The Inter-State Commerce Commission, under the Act of 1920, was instructed by the Congress to establish rates which would yield a net operating income sufficient to pay a fair rate of return upon the value of the railway properties held for and used in transportation. The rate was fixed at $5\frac{1}{2}$ per cent, with an extra half per cent for improvements chargeable to capital accounts (6 per cent in all) for the first two years. This applied to the railways as a whole, or to a group of railways, and not to

individual railways in a group. The rate which yields 6 per cent to all the railways in a group may yield more than 6 per cent to some and less than 6 per cent to others. No relief is provided for railways which earn less than 6 per cent, but when more than 6 per cent is earned by a railway the excess is divided evenly with Government, the railway holding its proportion in a reserve fund, and the half which goes to the Government being used as a general railroad contingent fund to be administered by the Commission in assisting the weak railways by loans. The reserve fund created by a railway from its excess earnings is to be held for interest charges or dividends in lean years, but when that sum is more than 5 per cent of its property value, the excess over 5 per cent may be used for any lawful purposes. The grouping of railways in America under this Act leads to economy. It has also led to a similar economy in Great Britain, where, under the Railways Act of 1921 (which came into operation in January 1923), all the railways are grouped into four systems, namely, (1) the London Midland and Scottish; (2) the London and North Eastern; (3) the Great Western; and (4) the Southern.

The question of separating the railway Budget from the State Budget was attempted in Prussia as long ago as 1878. The railways were too prosperous to allow the scheme to be achieved. In Italy, however, the railways have a separate Budget. In France the Budget which is worked by the State is treated as an "annexe" to the general Budget. In the South African Union Act it is provided that the railways of the Union shall be so operated that the gross receipts shall not be more than sufficient to cover working expenses, reserves, and interest on capital. If there is a surplus it is to be devoted either to improvements in facilities or reduction in rates. If, on the other hand, there is a deficit, rates and charges shall be increased to cover it. In Switzerland the Purchase Act provides that "the railway accounts shall be kept separate from the other federal accounts, so that the financial position of the railways can at all times be clearly ascertained, and that railway earnings shall be devoted only to railway purposes". The control of new railway capital issues and of railway tariffs, and the voting of the railway Budget are reserved to the Swiss Parliament, but any surplus of revenue after meeting working expenses, interest, and sinking funds is devoted to railway purposes. If the revenue fall short of expenditure, the State meets

the deficit. In Japan the railway Budget is entirely separate. The railways, under the Act of 1909, have a separate capital account entirely distinct from the general account. As the official report says, "This financial independence has given very great convenience and facilities in the management of the Imperial railways, as, indeed, it has made the railway finance one of special character among all the special accounts created by the Imperial Treasury. In short, the change has made the railway finance a financial agency specially adapted for the management of railway business."¹ The Finance Minister of India, in his Budget proposals of the 29th February 1924, proposed a scheme by which a Budget, separate from the general Budget, will be achieved, the Government receiving (1) a sum sufficient to pay in full the interest on capital invested by Government in commercial lines; (2) an additional dividend of five-sixths of 1 per cent on that capital; and (3) in addition a share of one-fifth of any surplus earnings that may be secured. The railways, on the other hand, will have the right to retain any surplus over and above what they pay to the Government, and to apply it to railway purposes, first of all in order to create reserves, and then by issuing these reserves to improve the services which they render to the public or by reducing the prices charged for these services. The Government of India and the Legislative Assembly are to remain in complete control of the railway administration as at present, and at the same time the railways will become, in the words of the Finance Minister, "a real commercial undertaking managed on commercial lines".

In the chapter on expenditure in regard to the commercial finances of Government (Chapter IX., paragraph 3), the advantages of trade railways as commercial undertakings were discussed. It is, however, essential to point out that in many countries any money not spent by the end of the financial year lapses when the railway Budget forms part of the State Budget, and the railways thereby lose their unspent balances. That is a great hindrance to efficient management. There are, too, (1) the difficulty arising from the receipt of funds too late in the year, so that funds cannot be spent advantageously, and (2) the futility of undertaking such projects when the continuance of funds in the following year is uncertain. Could anything be more bewildering than the letter

¹ Cf. Cmd. 1512, 1921, p. 35 (Acworth Report on Indian Railways).

sent by the Indian Railway Board to the Great Indian Peninsula Railway Company in December 1920 ? It runs as follows :

I am directed to inform you that five lakhs have been allotted in the six months' estimates with a view to making a commencement on the construction of the Warora-Pisgaon Railway from Majri to Rajur. I am to request that you will make arrangements for construction to proceed as quickly as possible with preliminaries up to the limit of this allotment. There is no expectation at present of any money being available for this line in next year and work may have to be temporarily suspended.¹

¹ Cmd. 1512, 1921, p. 22.

CHAPTER XXXI

LOCAL TAXATION IN VARIOUS COUNTRIES

1. GROWTH OF LOCAL TAXATION

THE enormous growth of cities and towns in the present century has been accompanied by a corresponding growth in local taxation, and there is, as never before, an everlasting struggle on the part of local authorities to make both ends meet. In dealing with the expenditure of Federal, State or provincial, and local authorities, we showed that it is not possible to have a clear-cut division of functions among them, and these functions, moreover, depend on historical, economic, and political considerations. They therefore differ from country to country, and in the same country vary according to the efficiency of local bodies. Some functions are nearly always left to the Central or Provincial Government; others are shared, such as those relating to education, police,¹ and roads; while others, such as public utilities, mainly the supply of water and lighting, are the peculiar sphere of purely local authorities. In Great Britain and the United States local self-government is highly developed. In the former the three landmarks, 1832, 1867, and 1884, mark the periods of internal and administrative reform that followed after each of them, a progress that has only been surpassed in the last quarter of a century. In 1885 the English system was described as "a chaos of areas, a chaos of franchises, a chaos of authorities, and a chaos of rates". To-day this is in reality far less true, especially as regards taxation. The Poor Rate, introduced by the Act of 1601, is still the basis of all local taxation. In the United States

¹ In Berlin, for example, the cost of the city police is met from the State Treasury, but the city contributes so much per head of population, which approximates to one-third of the entire cost.

local taxation has necessarily grown in importance to a large degree on account of the weakness of the State or Commonwealth Governments, and the corresponding strength of the purely local bodies.¹ Local authorities depend on their legislatures for the power to tax, and can levy only such taxes as are permitted under statute. In the assessment of property for the general property tax, local authorities are given considerable discretion. It is from the proceeds of this tax that the larger part of the revenue comes. Indeed it is from one-half to two-thirds of all the municipal revenue in cities over 30,000. Special assessments, to meet the cost of public improvements, are also a source of revenue. In some States there is a local income tax on incomes over a certain minimum, and in others poll taxes, payments from public utility corporations, business taxes, and State grants-in-aid of education and other services are also sources of revenue for local authorities. Direct taxation is of greater importance in American municipal finance than in Great Britain and Germany. In Great Britain it is one-half and in Germany one-third of the annual receipts. The percentage distribution of net revenue receipts of 146 cities in the United States was as follows :

	1913. (Pre-War Year.)	1919.
General property tax	62.4	66
Licence taxes	6.5	4.3
Other taxes	2.0	3.4
Earnings of public enterprises	9.9	10.2
Special assessments	8.2	5.6
Subventions	4.5	4.1
Other sources	6.5	6.4

In grants-in-aid, however, American cities have a small percentage, which one authority places, together with the proceeds of municipal enterprise, at never more than 12 per cent. In Great Britain and Germany grants-in-aid alone are from 16 to 20 per cent. In France ² the communal system of taxation, on the other hand, gives a considerable degree of power to superior

¹ Cf. Fairlie, *Local Government in Counties, Towns, and Villages* (New York : The Century Co., 1914), especially chapter xv. ; Munro, *Principles and Methods of Municipal Administration*, chap. x. "Municipal Finance" (New York : The Macmillan Co., 1920). The reports of the Bureau of Census and Statistics are full of information and may be consulted.

² Shaw, *Municipal Government in Continental Europe* (New York : The Macmillan Co., 1906), especially chapters i. and iii., with Appendix I.

authorities, the Prefect having large financial control in matters of taxation and, indeed, in the Budget as a whole. The influence of France on Belgium, Holland, French Switzerland, Spain, and Italy is clearly discernible.¹

2. SOURCES OF LOCAL REVENUE

Octrois in French municipal finance are, according to one writer,² 46 per cent of local revenues, 27 per cent *centimes additionnels*, 16 per cent special taxes and particular payments in the nature of fees, 10 per cent prestations—an interesting survival of the system still practised in Bulgaria of the *corvée* or forced labour—and 1 per cent Government assignments out of certain taxes. In Belgium³ communes have more extended powers to impose local taxation than in France and Italy,⁴ in the latter of which the permanent delegation of the provincial council (*deputazione provinciale*) takes in local taxation the place of the French Prefect. In Belgium octrois were abolished in 1860, and a communal fund now plays an important part since from it the communes receive a sum not less than their receipts in 1859. The agitation for the abolition of octrois began in 1839, and resulted in the legislation of 1860, when it was no longer necessary to chronicle the intestine war of tariffs. “Six declarations, six formalities, six transit dues”, said M. Richald before the abolition, “must be paid to transport a bottle of wine from Brussels to Liège.”⁵ In Belgium before the War the local additions to the State taxes were not many. Holland abolished octrois in 1865. There are, however, local special taxes. In Germany⁶ the division of functions is similar to that in Great Britain. The difference lies in the method by

¹ *Vide* chapters i. and iii., Shaw, *Municipal Government in Continental Europe*.

² Grice, *National and Local Finance*, chap. x.; *Communal Revenues in France*, p. 154 (London: King & Son).

³ *Idem*, chaps. xii.-xiv.

⁴ Shaw, *Municipal Government in Continental Europe*, chap. iv. “Recent Progress of Italian Cities”.

⁵ Louis Richald, *Les Finances communales en Belgique*, vol. i. p. 135 (Bruxelles, 1892, 4 vols.).

⁶ W. H. Dawson, *Municipal Life and Government in Germany*, chapters xiii.-xvi. “Municipal Finance” (London: Longmans, Green & Co., 1916); Shaw, *Municipal Government in Continental Europe*, chaps. v.-vii.; Grice, *National and Local Finance*, chaps. xv.-xx.

which local taxes are raised. The Prussian Communal Taxation Act of 1893, the "Kommunalabgabengesetz", usually known as the "K.A.G.", retained octroi duties. The first sections of the K.A.G. provide that—

(1) "The communes are authorised, in order to cover their expenses and meet their needs, to collect in conformity with the conditions of this present law fees (Gebühren) and special contributions (Beiträge), indirect and direct taxes, and to demand personal services."

(2) "The communes must use the power granted to them of collecting taxes only in proportion as their revenues, and especially the product of the communal domain, as well as the resources put at their disposal by the State or the higher local authorities, are not sufficient to cover their expenses. This restriction does not apply to the taxes on dogs, on articles of luxury and other analogous objects."

(3) "Industrial enterprises undertaken by the communes must, as a general rule, be administered so that the receipts may at least balance the expense incurred by the communes in connection therewith, including interest and sinking fund."

Wagner¹ indeed points out "that British local taxation excludes duties on articles of consumption, and hence it appears not better, but rather still more one-sided. The exclusive use of direct taxes is a defect. The English system can in no way be regarded as an example for the Continent." The German author considers that the simple British system of a rate on the annual value of real property is inadequate. It is suitable for that part of local taxation which confers special benefits such as on the owners of fixed property, but for expenditure on education and other national objects, which confers a benefit on no one in particular, he believes the burden should be distributed otherwise, in order to secure equality of sacrifice, for example, by an additional rate on the State income tax *Zuschläge* (like the *centimes additionnels*) or by indirect taxation like octrois.

In most German States local authorities obtain their revenue mainly from direct and indirect taxation, and from communal property, fees, and dues, special assessments, municipal undertakings, and certain grants-in-aid from State Governments. The percentage tax revenue is set out in the following table :

¹ *Finanzwissenschaft*, vol. iii. § 164.

Towns.	Percentage of each Tax to Total Taxes.					Total.
	Income Tax.	Real Estate Taxes.	Trade Taxes.	Consumption Taxes. Octrois, etc.	Luxury and Expenditure Taxes.	
Berlin	47	37	14	1	1	100
Towns in Prussia . .	53	32	11	1	3	100
„ Bavaria	32	26	33	7	2	100
„ Saxony	81	13	1	2	3	100
„ Württemberg . .	36	25	32	6	1	100
„ Baden	40	36	19	4	1	100
„ Other States . .	36	19	12	31 *	2	100

* In Metz (Alsace-Lorraine) the percentages are as high as 67 and 48 respectively (cf. French Octrois and Strasbourg).

State Governments emphasise the necessity of working municipal undertakings with as much profit as possible. Taxes are only to be levied when these undertakings with the income from the other sources mentioned above do not meet the required expenditure.

Again in a country like India the system depends on local peculiarities. In India it is the reverse of what we find in the United States. Provincial Governments are strong and local bodies, with rare exceptions, weak. Outside the Presidency towns (which had municipal government under Royal Charters and subsequently under statute) there was no attempt at municipal taxation before 1842, when an Act was passed for Bengal. In 1850 an Act for the whole of India took its place. It was not till 1870 that much progress was made, when Lord Mayo was Viceroy. The years 1881-2 and 1883-4 marked further advances. Some heads of taxation were laid down as specially suitable for local bodies. Municipal income is £11·4 millions per annum only, and of this two-thirds is derived from taxation and the remainder from municipal property, provincial Governments, and miscellaneous sources. Bombay, Calcutta, Madras, and Rangoon provide 38 per cent of this revenue. The taxation is light and education takes only 8 per cent of the total revenue as against 17 for conservancy, drainage 6 per cent, and water supply 9 per cent. In some municipalities, *e.g.* in Bombay, excluding Bombay City, the expenditure on education amounts to over 18 per cent of the total.

In Japan prefectures are divided into municipalities and

counties, and counties into towns and villages. The French method of additional percentages is the chief source of prefectural and purely local finance. Of prefectural revenues 52 per cent is obtained in this way, and in the case of municipalities 70 per cent; thus 48 and 30 per cent are derived from other taxes. Additional percentages are as high as 97 per cent of the total revenue of villages. Japan has followed the example of so many other States and towns of Europe, and used the French model to advantage. Many of the large cities on the Continent of Europe have, as we have seen, followed the example set by Paris in regard to their local governmental finance.

Local taxation is mainly spent on education, public health, poor relief, roads, housing, and development schemes, the provision of parks and open spaces, libraries, baths, wash-houses, museums, art galleries, and public utility services of an extraordinarily complicated nature. These undertakings are not always effected at a profit. Municipal trading in Great Britain, for example, in 1919-20 by the eighty-two county borough councils resulted in a net deficiency of £130,000 over all the undertakings, which included water supply, gas, electricity, trams and buses, markets, harbours, docks, cemeteries, and light railways. Certain undertakings, mainly water and gas supply, produced an aggregate surplus of £930,000, and others realised a loss of £1,060,000. It is interesting to take the returns of an advanced country like England and Wales in local taxation, and to exhibit its income and expenditure, as this gives a good example of the result of the growth of cities and towns referred to at the beginning of this chapter.

ENGLAND AND WALES

Local Taxation—Local Revenue

1918-1919		England and Wales.	Percentage.
Receipts from—		(£ millions.)	
Rates	.	85	43
Water, gas, and electric light undertakings	.	34	17
Tramways and light railways, etc.	.	17	9
Government contributions	.	29	14
Loans	.	4	2
Miscellaneous	.	30	15
Total receipts		199	100

Expenditure on—		<i>Local Expenditure</i>	
Education	43	22	
Electric lighting (other than public) .	13	6	
Gas works	14	7	
Harbours, etc.	12	6	
Highways, etc.	16	8	
Police and stations	10	5	
Poor relief	15	8	
Sewerage	6	3	
Tramways, etc.	16	8	
Waterworks	11	6	
Other purposes	42	21	
Total	198	100	

From what has been said, it will be clear that local taxation varies from county to county according to local conditions, and no one system can be said to be supremely the best. The British and American systems have many good points. So have those of France, Belgium, Italy, Germany, Japan, and other countries mentioned above. Some English writers have not always appreciated this fact when treating of the simple system of local taxation in Great Britain. "Much stress", says one critic,¹ "is usually laid on the independence which the English method is supposed to secure to local authorities. I confess myself entirely unable to appreciate the weight of this argument. Why should it be more independent to impose 1d. per £ on all rentals in the assessment roll, than to pay 1 per cent on all incomes detailed in the 'Kadaster'? Is a municipal council less independent than a poor-law authority because the latter makes up the roll, while the borough is furnished with it ready made and may not depart from it? Scotch local bodies are usually supplied with official valuations; are they therefore to be considered less free than their Southern contemporaries? The argument that French and German decentralised Governments are kept in leading strings by *centimes additionnels* and *Zuschläge*, while in England they strike out freely a line of their own, seems to me to be empty rhetoric."

¹ J. Row-Fogo, *Economic Journal*, vol. xi., 1901, "Local Taxation in Germany".

3. THE EXECUTIVE IN LOCAL FINANCE

Another feature that emerges from a survey of local taxing authorities is the necessity at the present time of separating purely executive functions from municipal and similar councils. This is imperative in view of the growing importance of local finance, and it is essential to concentrate authority as far as practicable and to define, if not to restrict, the powers of local authorities. Thus in the United States the fundamental principle of reform in city governments has been the attempt to fix responsibility by extending the power of the mayor, and while giving him the power of an executive¹ it takes from the councils, as far as possible, their executive functions. In Germany this is best illustrated by looking at the Berlin municipal constitution,² where the city administration is in the hands of an executive board, which is the executive for purely city affairs and also the State's representative for State functions. In the former it is responsible to the municipal council, and in the latter to the State Government. This executive (the *Magistrat*) is not bound to carry out the will of the city council, and it has the right, and, if the council wishes, may be required to send representatives to the meetings of the council. When the mayor (who has the right of veto over the board's decisions) is in conflict with the board the ultimate decision rests with the Supreme Administrative Court. In cases where differences arise between the executive board and the municipal council the Supreme Administrative Court is the first and final authority. In the cases of other municipalities the general rule is to appeal to the district committee as an administrative court, and finally to the Supreme Administrative Court. All members of the executive board, salaried and unsalaried, are elected by the city council. The municipal council's powers are not defined in the Act, but are limited in so far as powers are vested in the executive board and by the general sphere of municipal action through standing committees—the deputations—made up of city councillors and

¹ *E.g.* the Act for "the Government of Cities of the First Class" in Pennsylvania, known as the Bullett Act, 1885.

² Cf. Von Kaufmann's *Die Kommunalfinanzen* (2 vols., Leipsic, 1906); Dawson's informing *Municipal Life and Government in Germany*; Shaw's *Municipal Government in Continental Europe*, especially Appendix II. "The Budget of Berlin".

private citizens elected by the city council, and to which the executive board adds a number of its members. As one authority expresses it, "We have here one of the peculiar characteristics of the Berlin administrative system. It is an attempt to bring about a personal union between the executive and legislative branches of the city government and the general body of citizens."

The constitution of some commonwealths¹ in the United States forbids the State legislature (1) to allow any local body to lend its credit to other local bodies, counties, cities, boroughs, townships, or other incorporated district; and (2) to assume the indebtedness of any local body except in the case of insurrection or invasion. No local body is permitted to increase its indebtedness beyond a certain statutory percentage of the assessed property valuation without the consent of the electors at a public election,² or to contract a debt except by providing for the collection of a tax to meet interest payments and the repayment of the principal within thirty years.³ This has been done to check waste. It is a policy that has not been altogether successful. The fixing of a maximum tax rate has sometimes been an incentive to borrowing and to make future generations pay. In France⁴ the raising of extraordinary taxes or the contracting of loans as well as the approval of the Budget requires higher sanction—in the case of communes by the Prefect or in the cases of larger communes by the President of the Republic. In Italy as in Belgium the control over resolutions of the municipal council belongs to the permanent delegations or deputations of the provincial council. This has a stimulating effect on local taxation.

A strong executive in regard to taxation and financial advice is now essential. Some one of authority, not a mere accountant, but one well versed in pure finance, the loan market, and general principles of expenditure and taxation, is necessary to say "No", an authority which will be regarded pretty much as H.M. Treasury among Government departments in Great Britain. A careful scrutiny of the Budgets before approval and before the year

¹ *E.g.* the Constitution of Pennsylvania.

² Limited to 2 per cent above the statutory 7 per cent. This can be avoided by increasing the valuation of the taxable property.

³ Constitution of Pennsylvania.

⁴ Cf. The French Municipal Code (Shaw, *Municipal Government in Continental Europe*, Appendix III.).

commences, an examination of the appropriations or accounts after the close of the year, and a scrutiny of proposed loans¹ should be general. An efficiency audit is required as this looks at results obtained and discovers when they are an unsatisfactory return for the money which has been spent. A detailed survey or enquiry into taxation with a view to economy is advantageous and should be undertaken once in every quinquennium by an impartial authority. Otherwise there may be waste of local funds and high taxation owing to unnecessary expenditure and local indebtedness mounting up more quickly than income from rateable property.² Profits, too, which are made from municipal trading should be regarded from a commercial accounting point of view, due allowances being made for depreciation, sinking funds, etc. Occasional and amateurish enquiries have not the bracing effect on local taxation which expert enquiries have, as the latter give full and authentic information upon the merits of expenditure as well as its legal propriety. One's finger can thus be put on unnecessary expenditure and taxation. The existence of such a curb on municipal enthusiasm is advantageous. It prevents illegal expenditure, and compels adequate expenditure on education and all other matters of public administration. Above all, it keeps local taxation within reasonable limits.³

¹ Cf. English Local Loans Act, 1875. Unfortunately in Great Britain private legislation in regard to this has not been beneficial in the long run. Parliament has been much too lax; cf. the absence of this in France and Germany. In France and Germany recourse is not had to a central department but to a higher local authority; cf. London County Council, which can sanction loans proposed by the London Borough Councils.

² "The Growth of Municipal and National Expenditure and Local and Imperial Burdens", Lord Avebury, *Journal of Royal Statistical Society*, vol. lxiv., 1901.

³ Cf. Percy Ashley, "The Financial Control of Local Authorities", p. 182, *Economic Journal*, vol. xii., 1902. Cf. English Local Government Act, 1894, and the "adoptive Acts" for the establishment of libraries where local authorities in Prussia cannot increase the addition to the State income tax by 100 per cent without sanction.

CHAPTER XXXII

LOCAL TAXATION (*continued*): METHODS

LOCAL receipts are derived mainly from one or more of the following sources :

1. A tax or rate on real estate (land, buildings, etc.) ;
2. An addition to a State income tax ;
3. A tax on trades and industrial pursuits ;
4. A tax on imports and exports (*octrois*) ;
5. A tax on public utilities, *i.e.* by charging for public utility services in such a way that profits are made and used for the relief of rates ;
6. A special additional tax on site values ; and
7. Grants from the State treasury assigned to local authorities as grants-in-aid or subventions.

With each of these we shall deal separately.¹ It is not intended that all these sources of revenue should be used at the same time, irrespective of the financial necessities of local bodies. The taxpayers' interests are safeguarded mainly through the Committees or deputations of local bodies and by the local bodies themselves, as described in the previous chapter.

1. RATES ON PROPERTY OR REAL ESTATE

The English word "rate" is ordinarily used to mean a direct tax levied by a local authority in the district in which the person assessed lives or has property. "Rate" is sometimes, but not accurately, used to include a charge made by a gas or water

¹ There is no essential difference between local and Imperial finance, and the same principles are applicable in both cases.

company. In Scotland the term assessment is frequently used. In Great Britain it is levied on the annual value of immovable property. In England and Wales agricultural land since the passing of the Agricultural Rates Act of 1896 is given preferential treatment. Apart from buildings agricultural land is assessed at half its annual value. In England and Wales rates are levied on occupiers, and in Scotland they have been levied half on occupiers and half on owners since the seventeenth century.¹ When the estimated local taxation required is known, the rates are raised by an equal rate in the £ on the rateable value of the area. Some rates are onerous, others beneficial. To the former class belong poor rates and education rates which do not show a direct return. Beneficial rates are intended to benefit the owners of property in the area. Expenditure on streets, lighting, parks, etc., is likely to increase the value of immovable property, and it is not unfair to call on owners—it is less fair to call on occupiers—to contribute to the expenditure incurred in proportion to the value of the immovable property. In regard to occupiers it is assumed that the annual value of their property is an index of their ability to pay. This is, in reality, a compromise (and not a very good one at that) between the principle of benefit and the principle of ability. Occupiers benefit from the expenditure of local authorities, and the richest pay the most. New onerous rates, however, such as those on education, cannot, of course, benefit owners in any degree proportional to their property, and are in this respect liable to criticism on grounds of inequality. Nor can they be said to benefit occupiers. In regard to old onerous rates and beneficial rates the burden is less inequitable. Such a rate or tax imposes no net burden on new purchasers of the land, and it may be regarded like the land tax which “is now past all controversy a rent charge”.² “Beyond all doubt, there is a substantial portion of the rates which can only be regarded as an ‘hereditary charge’ of the same nature as land tax or a mortgage which has been subsisting on the family estate for several generations. If A has derived his property under a settlement made by his grandfather who bought the property subject to heavy rates, and who therefore on that account paid a

¹ S. H. Turner's *History of Local Taxation in Scotland*, p. 7 (Blackwood & Sons, London, 1908).

² Sir Robert Giffen.

smaller price for it than he would otherwise have paid, it is a mere fraud on the part of A to pretend that the rates (*i.e.* the part of them which has been permanent for three generations) are a real burden upon him. The permanent portion of the rates must be omitted from the account when we try to determine what portion of the taxes are a burden upon persons in respect of their own real property, and until some estimate is formed of this hereditary charge and it is eliminated together with the land tax, it is futile to produce figures to show that the unhappy landowner is overburdened. The lessees of Crown property might as well be permitted to call the ground rent which they pay part of the burden of taxation which they bear.”¹ Rates which are of long standing on immovable property tend to be capitalised and impose no net burden on new buyers of land.

In Germany the principle of taxing on the British rate plan of annual rental has now almost entirely disappeared. No new taxes on rents, *i.e.* “rates” on rental value, can be introduced in Prussia to-day. The old system of assessing land and buildings is, at least in towns, far less popular than it was. In Prussia (which is not far short of two-thirds of the total area and population of the German Reich) under the land tax law of 1861, the tax is paid by the owner according to fixed valuations now long out of date. Under the same law the tax on buildings is paid by the owner on the annual value revised once only in fifteen years. Since the Communal Taxation Act of 1893 wide discretion has

¹ Sanger, *The Report of the Local Taxation Commission* (Cd. 638, 1901), *Economic Journal*, vol. xi., 1901. This Commission was appointed “to inquire into the present system under which taxation is raised for local purposes, and report whether all kinds of real and personal property contribute equitably to such taxation; and, if not, what alterations in the law are desirable in order to secure that result”. Other reports of interest are *Report of Poor Law Commissioners on Local Taxation*, 486, 1843; *Report of Select Committee on Local Taxation*, 353, 1870; *Report of Mr. Goschen to Poor Law Board*, 470, 1870, reprinted as 201 of 1893; *Fowler’s Report on Local Taxation*, 168, 1893; *Final Report of the Departmental Committee on Local Taxation*, Cd. 7315, 1914, with Appendix (Cd. 7316, 1914); also the *First Report of the same Committee with Appendices* (Cd. 6304, i., and 6304, ii., 1912). This Departmental Committee’s Final Report is not of importance and the evidence is one-sided.

Professor E. Cannan’s admirable *History of Local Rates in England in relation to the Proper Distribution of the Burden of Taxation* (2nd edition: London: King & Son, 1912), Wright and Hobhouse’s *An Outline of Local Government and Local Taxation in England and Wales* (4th edition; London, 1914), and the late Mr. S. H. Turner’s *History of Local Taxation in Scotland* (Edinburgh: Blackwood, 1908) should be consulted.

been given by the State in regard to these taxes. The assessments are still made by the State, but local authorities were left free to alter the manner of assessment, except that where the taxes were not modified, taxation was to be by additional percentages to the State assessments. Larger communes tax from 200 to 300 per cent of the rate of tax, while the usual is 150 per cent, and up to 100 per cent the amount of the tax may be deducted from income declared for income-tax purposes. In the larger municipalities not only in Prussia but elsewhere in the Reich the basis of taxation of real estate is now *market or sale value*, which has been defined to be "not the capitalised value of the annual rent, but the price which could be obtained by sale under ordinary circumstances". This method of taxing real estate was introduced in Berlin in 1908, and was uniform for all classes of property, and, as already noted, has spread rapidly to other larger towns. The tax varies from one-fifth to one-half per cent. Some towns which have not adopted the sale value basis have still the rental value. The advantage of adopting sale value as the basis of assessment is not necessarily to produce more revenue. That may be done by simply increasing the percentage levy on the State assessment. The gain arises from the fact that the burden of taxation on the various kinds of property is far more equitable.

In Prussia and certain other States a property transfer tax on the value of real estate changing hands by sale or otherwise is very popular, and every town of importance now adopts it. The tax is paid by the purchaser on a percentage of the actual or market price, except that transfers by bequest are frequently exempted. The tax is at the rate of 1 or 2 per cent, but higher rates may be charged. In Bavaria the State itself imposes a tax of 2 per cent, and communes since 1898 may levy $\frac{1}{2}$ per cent for their own purposes. In Saxony the Communal Taxation Law of 1913 fixes a maximum limit for all purposes of 2 per cent. In Saxony real estate is taxed leniently as compared with Prussia and other States.

The assessment of real property is the main source of local taxation in the United States, and is done by city and town officials as well as by county officials. The assessed value is not always the market value of the property. In Chicago, for example, real estate for assessment purposes is valued at about

one quarter of its market value. Buildings are not always valued separately, but a lump sum is put down for the land and buildings. The valuation figures are used ordinarily for both city and county purposes, and also for the State where the property tax is levied for State purposes. Valuable lessons are to be learned from the American system of valuation, especially that in force in New York. Speaking generally, it may be said to illustrate all the faults likely to arise from putting into untrained hands a difficult and technical matter. Sometimes the method of valuation is not uniform even in the same city. "How the assessor arrives at this value is known only to himself. Although the laws usually stipulate that he shall assess property at its fair market or cash value, and thus give him a quasi-judicial duty to perform, the average assessor often sets up his own standards in violation of this statutory instruction. He begins, as a rule, by taking the values set by his predecessor upon the properties, and then proceeds to raise or lower these or to leave them as they were. Sometimes the assessors follow the general policy of making all valuations low in order to attract industries to the city or to ease the burden of State and county taxes. Sometimes, on the other hand, they try to raise assessments all along the line in order to keep the nominal tax-rate down or to enhance the city's borrowing power when this is fixed in terms of total valuations. Some assessors arrive at a value for buildings by estimating what an owner could get for both land and buildings, and then deducting what he could probably get for the land alone ; others estimate the original cost of the buildings, less depreciation ; others, again, try to set down the reproduction cost. Although uniformity in such things is what statutes require and what fairness demands, there is usually no approach to it among different cities of the same State or sometimes in different parts of the same city." ¹ In New York city, however, a very elaborate system of classification of buildings according to type, cost per square foot of floor space, etc., is used, and other tests such as the price at which a building of this class was sold or current rental values are also taken into consideration as checks. New York has found this scientific method both practicable and remunerative.

¹ Munro, *op. cit.* p. 415. In assessing personal property under the property tax the assessors usually fix a sum which will be paid without protest or appeal to higher authorities.

THE INCIDENCE OF THESE TAXES

Elsewhere we have already touched on the incidence of local taxation. The question is by no means a simple one. There is a good deal of economic friction, which has to be carefully examined. In the first place the annual value on which British rates are levied include site value and building value, which are, of course, not separately levied. A rate on the site value tends to fall on the owner of the land, the ground landlord. The supply of land is not curtailed by the imposition of a new or enhanced rate or tax. A tax, however, on building land values will fall mainly on the occupier, except if the building is used for business purposes, when the customers may pay the tax. The tax will not fall on the owner, because buildings would not be put up until a shortage led to an increased return sufficient to give a normal return on capital. If new or increased rates are levied on the occupiers these will tend to rest where they fall and for occupiers to bear for a considerable time the entire burden of new rates. The occupier, for example, may be unable to secure a new house until the expiry of the lease. He may, if the building is used for business, in the meantime succeed in passing the tax on in the form of an enhancement in the price of goods to consumers of his goods, or he may be unable even then to secure other accommodation on account of a scanty supply of houses, or it may be essential for his work that he should live where he at present is. In these cases the position of the occupier is anything but strong. Owners, however, in the case of new rates, may find themselves compelled to pay the increased rates or to have their buildings unoccupied. The owners of old buildings may have to bear part of the new rates for long periods, especially if the rates are higher than neighbouring suburbs. Occupiers will, without much difficulty, evade the tax in this way, while owners of the buildings cannot, as buildings cannot be lifted and erected quickly elsewhere. On the whole, investors who build houses will shun the district, and the differential rate will fall on the ground landlord. In short, then, while the taxes or rates on site values tend, *ceteris paribus*, to fall ultimately on the ground landlord, those on building values fall ultimately on the occupier or consumers. Economic friction takes place, and occupiers who in England and Wales bear the rate may, unless they are able to move to an adjacent area more lightly rated and evade

the rate, bear the burden of increased rates for a considerable time, especially if there is a scarcity of houses. Where, as we have seen, rates in one district are higher than in a neighbouring district the ground landlord bears ultimately the whole differential burden.

2. AN ADDITION TO INCOME TAX

In France, Belgium, and Germany a large proportion of local taxation is obtained by means of additions, voted by communes, to certain State taxes. Such a system would not be suitable in those countries which, like Great Britain, have already a highly developed income tax system. This, however, does not mean that the proposal is impossible of adoption in many other countries, and the example of Germany in recent years, where the tendency has been to follow the example of Prussia in local taxation, is very interesting especially in the Bavarian law of 1910 and the Saxony law of 1913. The following data show at a glance the French system :

THE FRENCH DIRECT CONTRIBUTIONS *
(Millions of Francs)

	State.	Departments (<i>Centimes Additionnels</i>).	Communes. <i>Centimes Addi- tionnels</i> plus 8 per cent of Patentes (Licences).	Total.
1838 . . .	293	61	33	387
1860 . . .	304	103	76	483
1885 . . .	406	174	176	756
1900 . . .	476	194	213	883
1906 . . .	523	214	245	982
Percentage of total for year 1906	53%	22%	25%	..

* *Vide* table p. 369, *National and Local Finance*, Grice. The departments and the communes alone (not the *arrondissements* and *cantons*) are of importance for ordinary financial purposes. The *arrondissements* and *cantons* are mainly for judicial, military, and electoral matters and are unincorporated.

Provincial *centimes additionnels* to State taxes were in Belgium nearly 10 million francs in 1905 out of a provincial tax revenue of 19 million francs. The total provincial receipts for the year were over 24 million francs. Local additions to income tax both in towns and in country communes in Germany are the largest

source of income.¹ English writers urge against an addition to income tax for local purposes (1) that the income tax when so applied is difficult to administer, *e.g.* it is very difficult to levy a local tax on movable property which is incapable of evasion; (2) that it is no easy matter to distribute the tax between communes in which an income was earned and those in which it may be spent. "Double taxation" is likely to arise.

These criticisms are not insuperable, and in the countries referred to above, especially in France, have not given rise to very great difficulty. We have already referred to the fact that with the abolition in 1914 of "the four old women"—the *contribution foncière*, the *contribution personnelle et mobilière*, the tax on doors and windows, and the *contribution des patentes*—provision was made that Government should continue, at least temporarily, to collect on the old basis the *centimes additionnels* for the communes. The process of adding hundredths to State taxes is not a difficult matter, the State Governments limiting as a rule the maximum number of hundreds that may be levied for general or special purposes.

The Prussian income tax has many points of difference from the British income tax. It is not so important as a source of revenue, and it is not levied at the source. The Prussian Government reserves the right to sanction or refuse permission to communes to levy an addition more than 100 per cent of the State income tax. This prevents excessive taxation of income especially for local purposes, which would in turn lead to evasion by under-declaration.² The communes may tax, in regard to their additional hundredths, incomes below the minimum fixed for the State tax, as it is impossible to relieve all citizens. This adds to the cost of collection. State officers (assisted by non-official assessors corresponding to Commissioners of Income Tax in Great Britain) make the assessment. A revision may take place by the Appeal Commission and by the *Oberverwaltungsgericht*, the final revising authority. The tax is graduated with great thoroughness, and is paid by those who reside in the commune for three months or more, and also (1) by those who do not reside but have property

¹ Paul-Dubois, *Essai sur les finances communales*, Paris, 1898; Dawson, *Municipal Life and Government in Germany*.

² Rates of 125 to as high as 300 are found in Prussian towns. In some rural communes the rates are even higher.

or business, and (2) by companies, including State public utility companies. The State pays the local additions for railways and also for mines or industrial enterprises that belong to it. House-owners have to report the names of those living in their houses, and employers similarly must, if required, report the names of employees with incomes not exceeding a fixed sum. Exemptions are granted to charitable institutions and to certain people, mainly officials, who are liable to transfer at any time. If a resident in a commune derives his income from other communes, these communes share the tax with the commune in which he resides. The income, however, from immovable property is subject to tax only in the commune in which it is situated, but this may have to be shared with other communes. If the immovable property is outside Prussia in whole or in part, the commune in which the taxpayer resides will receive also a share of the income arising from this source. To deal with any difficulties that may arise there is a detailed code of rules, and in addition there is a close supervision of property and other sources of income combined with a system of registration of property.

Two facts are of importance: (1) the system is not looked on as unfair—this (and a large) portion of the local rates being levied (mainly quarterly) according to equality of sacrifice—and (2) the willingness with which the required declaration is made by those whose incomes are over a fixed minimum. The communal income tax can be evaded as, for example, in Berlin and other cities by people who move out to the suburbs.

To sum up: the difficulties of a local income tax are the impossibility of accurately localising income and the danger of evasion by migration to areas where a lower rate of local income tax obtains. We are sometimes apt to underestimate the value of high local taxation in preventing people bunching together in crowded areas and in spreading them in the suburbs of large towns. On the other hand, local conditions do frequently justify a tax of this sort, as in Germany. In an official report¹ it is said that “the system prevailing in Prussia is thorough and just. The limit of incomes relieved of all taxation (for State purposes) has been raised to 900 marks against formerly 600 marks. This measure not only relieved additional members of the poorer classes, but simplified the operation of the whole system. The

¹ Cmd. 4750 (1909).

law of 1891¹ also introduced the self-assessment or 'declaration' of those enjoying an income of 3000 marks or more. The results of this innovation have proved nothing short of splendid . . . the honesty prevailing in these self-assessments was a surprise even to the optimists." The tax is not looked on as unjust, even by the working classes. The German system, like the French, of imposing an addition according to local requirements—*Zuschläge* and *centimes additionnels*—has indeed much to commend it. As a general rule an additional percentage on State or Federal income taxes depends greatly on local circumstances and the nature of the income tax. An additional percentage on a Federal income tax for State purposes is possible in many countries; to transplant, however, the system of income tax *for local purposes* to other countries is a more difficult and indeed a more doubtful proposition, and would not be easy in countries, like Great Britain, with a highly developed income tax based on the principle of collection at source.

3. TAXES ON TRADE AND ON PROFESSIONS

Taxes on trades and professions for local purposes are a not unimportant form of taxation. In France these are levied in such a way as to secure payment according to ability. Small farmers are exempt, and other trades and professions are divided into groups according to the supposed ability of the taxpayer to pay. These groups are again subdivided according to the population of the communes, Paris and the larger communes paying higher rates than the smaller. The subdivisions may also be divided according to the letting value of the trader's establishment, and in some cases according to the number of his employees. For licences there are also main groups with subdivisions according to the population of the commune. The main groups are: (1) shopkeepers, etc.; (2) bankers, brokers, importers, and exporters; (3) manufacturers; and (4) members of the liberal professions—lawyers and doctors. In Germany the system was probably copied from France over a century ago. The tax is primarily a State tax, except in Prussia and Saxony. In Prussia, for example, before 1893, traders and manufacturers were taxed. Since 1893, traders are divided into four classes, according to the

¹ The law of 24th June 1891 establishing a reformed income tax.

size of undertakings, the capital employed, and gross profits, either ascertained (as in Prussia) or estimated arbitrarily. The tax before the War was not high, being about 1 per cent of the yield. The professional classes and the working classes were exempt, save in towns like Bremen. Wherever it can be arranged, the communes try to base the tax on criteria other than profits in order to get a steady "flow of revenue". If a business is carried on in more than one commune, the tax is divided, and, as in the case of the tax on the capital value of land and the tax on the capital value of buildings, the commune may levy additional percentages for local purposes up to 200 per cent of the State taxes, but the amount of the tax up to 100 per cent may be deducted from the income declared for income tax. Commercial or industrial enterprises of the State or commune have to pay the tax if they earn revenue. In addition to the tax on trades (*Gewerbe*), there is a tax on certain occupations (*Betriebsteuer*), which include hotel- and restaurant-keepers, and retailers of beer and spirits. These annual licences are paid before commencing business.

4. INDIRECT LOCAL TAXES—OCTROIS

France, Italy, Germany, and other countries used octroi duties as a source of local taxation. British and American writers look on such duties as expensive to collect, easy to evade, and a hindrance to trade.¹ These criticisms vary in importance according to local conditions, and in some municipalities of India to-day, for example, octrois are a useful source of revenue, notwithstanding their unpopularity in other parts of the country. Towns and cities are no longer forts hedged in with walls as formerly, and in place of transportation by road there are railways. Hence the tax is not so easy to collect as formerly, while, on the other hand, a customs examination at terminals is inconvenient, although not very difficult. In France taxes on consumption for local purposes are an important source of revenue, varying from one-third to nearly one-half of the total receipts of the communes. These taxes were abolished in 1791, but were re-imposed gradually in the next twenty years, beginning, as we have seen elsewhere, with Paris in 1798. In towns with less than

¹ *Vide* also Chapter XXVII. p. 390.

4000 inhabitants, necessities of consumption are usually free. The cost of collection was before the War about 11 per cent of the gross revenue. In Germany octroi duties are a much less important source of revenue than in France, as is shown in the table on p. 376. In Germany since 1910, corn, vegetables, meat, meat products, and cattle have been exempted under a Customs Tariff Law, and this told heavily on the finances of communes, especially those of South and West Germany, where the octrois were an important receipt. The cost of collection remained constant. To make up for the loss, the charges for slaughter-houses, the rates of octroi on other articles and on income tax were increased, and in others amusements taxes have been introduced, as in Prussia, Bavaria, and Saxony.

The main criticism against these duties as a source of revenue is that they are a hindrance to trade. This was a main, if not the chief, cause of their abolition in Belgium.

5. TAXATION FROM PUBLIC UTILITIES

In some countries the cost of local administration has in part been met from municipal trading. The charges for these undertakings have been fixed to yield a profit, which is used to relieve local taxation. In many German cities public undertakings have been worked efficiently, and there are valuable concerns yielding a large profit to the taxpayers. There are cases, too, of communes which by reason of these are exempt altogether from taxation. Klingenberg in Bavaria, owing to forests and valuable clay pits, yields to its two thousand inhabitants, after meeting all public expenditure in the commune and adding to a reserve fund, an annual dividend in cash.¹ Seeburg in East Prussia and Enkirch on the Moselle are similarly free from local taxation. Other local authorities, both in Germany and Austria, make the most of their public utility enterprises, and are urged to do this by their Governments. In many cases the services provided by municipalities (*e.g.* gas and electricity works, and also tramways) do not always provide large profits. Berlin, however, is an exception, since its proceeds from gas works, electricity works, water works, and tramways, after making all allowances for

¹ It is, of course, difficult to become a citizen of the town. Residence for twenty-five years is necessary.

depreciation, payments of interest, etc., were before the War over £1 million sterling. A dozen other German cities also made considerable sums. An objection may be raised to this form of taxation in cases where the undertaking in question is not used by all classes. The tax falls on the classes which patronise the concern, often wage-earners, and others more able to pay escape the tax. Thus a tax of this nature from tramways would not fall on the owners of motor cars but on the wage-earning and clerical classes. This argument against making profits to relieve local taxation is frequently given too much importance by English writers.

6. THE TAXATION OF SITE VALUES

In a previous chapter a reference has been made to the taxation of site values. For local purposes a special tax on the value of land apart from any structure on it has proved to be a useful subsidiary source of revenue. Site values have increased and are increasing rapidly in large cities, and also in towns. Owners of land gain more from local expenditure than other taxpayers. Why, therefore, should the tax not be generally imposed? It will not check improvements. Site value being a differential rent, a tax on it cannot be shifted. A tax on differential rent does not interfere with the supply of land. It does not, in short, affect production.

Since the tax was first introduced in Germany in 1904 by the municipality of Frankfort-on-Main it has spread rapidly, and to-day "the increased value" tax is to be found in Berlin, Cologne, Essen, Frankfurt, Leipsic, and many other towns. The Prussian Communal Taxation Law of 1893 mentions it as a source of local taxation which would check speculation in land values and assist thereby the housing problem. The tax is levied on the excess of the price or value on re-sale or transfer over the previous price or value when the property last changed hands. The tax is paid by the seller and is a progressive one. Below 10 per cent increased value is usually exempt; and from 10 to 20 per cent the tax is often 6 per cent. The tax increases for every 10 per cent of increased value by 2 per cent, and is 25 per cent on over 100 per cent. The rates are not uniform but vary from city to city. The seller is as a rule permitted to

deduct all expenditure on permanent improvements* such as roads, and if the land is not used by the owner for agricultural or industrial purposes he may add to the purchase price an amount for keeping the land in good condition, and for a return (before the War 4 per cent) on capital.

The Royal Commission on Local Taxation of 1901 pointed out that "the mistake made hitherto has been to regard the taxation of site value as primarily a question between the parties interested in any one hereditament, or as essentially depending on the rights or wrongs of the dispute between the ground landlord and the string of lessees as to the fairness of their contracts.

"The real question as to the taxation of site value is the question whether there ought not to be a tax on site value where it exists, and in proportion to the amount of it which exists in each place. In other words, site value is, in essence, *local*, and the effect of taxing site value would be primarily a *local* redistribution of burden, not primarily a redistribution of burden as between the parties interested in each single hereditament, but as between different districts and different hereditaments." ¹

The tax is so productive that State and Imperial Governments may demand a share. Thus the Government of the German Reich passed a law in 1911 (since repealed) of appropriating 50 per cent of the proceeds for itself, 40 per cent for the commune in which the site value is, and 10 per cent to the State Government for cost of collection. The communes were permitted to add "additional percentages" with the approval of the State Government, but the combined federal and communal tax was not to exceed 30 per cent of the increased value. This form of local taxation has grown rapidly since the early years of the present century in popularity. As a source of local taxation it is a good tax, its productiveness in cities has been very noticeable, and it is not improbable in the near future that this form of local taxation may be adopted in other parts of the world, especially in the self-governing Dominions and also India, where in large towns site values are rising with the increase in population.

¹ Report, p. 165.

7. GRANTS FROM STATE REVENUES

Another source of revenue for local authorities is the grant-in-aid or subvention from the State Treasury. An examination of the local Budgets in many European countries of importance shows this to be a feature of local finance. To-day local authorities perform duties or services of the greatest national importance, especially in regard to education and sanitation, not to mention the prevention of crime and the upkeep of important roads. Poor districts would suffer serious injustice were assistance not given. We need, therefore, hardly stop to consider the advisability of these grants. The difficulty is (1) how should the grants be distributed in order to prevent financial weakness, that terrible disease that creeps over many local authorities? and (2) what should be subsidised?

In Germany two principles in local taxation are followed: (1) the granting of relief without any inquiry into individual necessity and regardless of the wealth or poverty of the locality; and (2) the granting of relief according to individual necessity. Under the former system grants are distributed, half according to population and half according to area. Under the *lex Huene*¹ in Prussia one-third of the "dotations" was given according to population, and two-thirds according to the yield of certain taxes. Grants-in-aid without any inquiry into individual necessity lead to unnecessary expenditure or extravagance and are, therefore, unsatisfactory. It is a sort of "tip" to a local authority, and is, nine times out of ten, squandered. There is the further criticism that such a rough basis for distributing grants becomes rapidly obsolete, and the change in the relative positions leads to the necessity for a change in standard if injustice is to be avoided. Some localities are progressive, others stationary.² Grants or subventions distributed according

¹ 14th May 1885, repealed by the Communal Law of 1893, with which Dr. Von Miquel's name is associated. This "*Kommunalsteuernotgesetz*" was the only general State grant-in-aid ever permitted in Prussian finance to communes, and proved unsatisfactory.

² "An interesting table was handed in as evidence before the Royal Commission showing the sums received in 1888 and the alterations which would be now necessary if the standard of distribution were brought up-to-date. In some cases an adjustment of from 55 to 45 per cent would be called for; in other more stationary localities the change would only involve an alteration equal to .3, .7, or .8 per cent. In Belgium also a similar idea was adopted

to individual necessity are the only form of which German statesmen approve. In theory a grant-in-aid is contrary to the German policy of local finance.

The Chairman of the Royal Commission on Local Taxation (1901), Lord Balfour of Burleigh, put forward an interesting scheme by which grants-in-aid would be distributed in Great Britain in the form of "block grants" for each service and distributed according to the needs of the localities. The measure of ability is the rateable value. He estimates necessity for expenditure partly by population and partly by actual expenditure: "The suggestion which I put forward is that 'block grants' should be given for each service taken as a whole, and that, in the distribution, some attempt should be made to equalise the burden remaining to be charged upon the various localities. With this object in view, the conditions to be observed would appear to be the varying circumstances of the different districts as regards, first, ability to raise local funds, and, secondly, necessity for local expenditure upon the services assisted. Having established criteria of these two conditions, the grants should be distributed in such a way that most would be given to those districts which have the lowest ability and where expenditure is necessarily high, and less to those with the greatest ability and less necessity for expenditure."¹ He fixes a minimum expenditure that is everywhere necessary, and a minimum standard rate that every local authority should raise. The grant would be (1) the difference between the amount of expenditure based on the minimum standard expenditure per head and the amount produced from the minimum rate on rateable value; (2) since actual expenditure is also to some extent a measure of the necessity for expenditure, he also proposes to give a part, *i.e.* one-third of the expenditure in excess of the assumed expenditure. The scheme has two features: it makes (1) for economy, and (2) for equalising the burdens of local taxation.

In Great Britain the percentage grant system has been applied to education, public health services, and to other

when octrois were abolished in 1860. The State handed over the proceeds of certain taxes to the local authorities in accordance with a standard considered equitable at the time. Twenty years later the result was utter confusion. In France the same state of affairs is said to exist" (Row-Fogo, *op. cit.*).

¹ *Op. cit.* p. 74.

activities.⁹ Before the War *per capita* grants were in force. These grants are usually 50 per cent, but vary from 20 to 75 per cent. The criticisms of the Geddes Committee on National Expenditure¹ are so apposite that they deserve quotation *in extenso* :

The advantage claimed for the percentage grant system is that it provides a stimulus to authorities to improve the efficiency of their services ; in fact, it is a money-spending device.

The vice of the percentage grant system is that the local authority, which alone can really practise economy in these services, loses much of its incentive to reduce expenditure, especially when the larger proportion is paid by the taxpayer through the Exchequer. The deciding voice as to what money shall be spent is not that of the Government or the House of Commons, but that of the local authorities. The Departments are thus in great difficulties in framing estimates, for these are based on anticipations not of what the Department itself will do, but of what hundreds of local authorities may do. The weakness of divided responsibility is manifest throughout.

If the Government were to attempt to impose a real and effective check from the point of view of efficient administration as well as audit, it would result in an enormous increase in bureaucratic control. It would mean a detailed scrutiny of accounts and an examination of all new expenditure. This would tend to overload the central machine, diminish local responsibility, and lead to greatly enhanced administrative cost. We do not suggest that the local authorities are negligent, nor do we suggest that they have not been directed to incur expenditure in conformity with a policy which, if left to themselves, they would not have incurred. We consider that the percentage grant should be abandoned in the interests of economy and be replaced by fixed grants or by grants based on some definite unit. Even though it were necessary to maintain the charge to the taxpayer at its present very high level, which we do not admit, the change would still, in our opinion, be very beneficial to the country by :

- (i.) Increasing the incentive to local authorities to economise.
- (ii.) Restricting the growth of the demands on the taxpayer.
- (iii.) Enabling staff economies to be effected at headquarters.

In the case of the grants to local authorities for housing purposes, the system adopted has gone even beyond the percentage grant at its worst. Here the local authority has lost all financial incentive to effect economy, because the annual loss in excess of a 1d. rate,

¹ Cmd. 1581 (1922), pp. 105-6.

say, $\frac{1}{4}$ ths of the total, is entirely at the cost of the taxpayer. Here we have a vast partnership in a property. The managing partner, viz. the local authority, has absolutely no financial incentive to economy, as no saving he effects redounds to his own benefit. The taxpayer, through the Exchequer, pays the whole excess, which is estimated at 10 millions a year for sixty years.

Government grants to local authorities vary in different countries. In England and Wales these were 15 per cent of the total revenue of local authorities in 1918-19, 2 per cent in New Zealand in 1921-22, and in India 21 per cent of the ordinary income of municipalities in 1920-21. In Great Britain the major portion of these payments out of the Consolidated Fund to Local Taxation Accounts are the equivalent to the proceeds, in some cases of 1908 and in others of the current year, of certain excise licence duties, part of the beer and spirit duties, and part of the probate and estate duties.¹

Grants-in-aid should not be regarded as bad, owing to the services of great importance to the State undertaken by local authorities in most countries. The State has to be sedulously careful to see that there is no waste on the part of local authorities. It has also to equalise the burdens of onerous rates in different districts to undertake all that is required of them.

¹ In 1921-22 the payments to England and Wales, Scotland, and Ireland were as follows :

On account of estate, etc., duties	.	.	.	.	£5,600,000
On account of licence duties	.	.	.	.	3,300,000
On account of beer and spirit	.	.	.	.	1,400,000
On account of other grants	.	.	.	.	900,000
					<hr/>
					£11,200,000

BOOK IV
PUBLIC DEBT

CHAPTER XXXIII

THE GENERAL CHARACTERISTICS OF PUBLIC DEBTS

IN Book II. Chapter XI. the theory of public debt was discussed, and it was shown that expenditure from loans as distinct from expenditure from revenue is in certain circumstances justifiable and expedient. The question of public debt may now be examined in detail, and this may be done conveniently from three points of view : (1) the characteristics of public debt ; (2) the burden of public debt ; and (3) the repayment of public debt, a question which includes a study of that vexed problem known as the capital levy.

1. THE IMPORTANCE OF PUBLIC DEBT

“ It is only just over five years ago ”, said Mr. Lloyd George in the spring of 1924, “ since the last guns ceased firing in a war of concentrated destruction such as the world has never seen. It cost the belligerent nations over £50,000,000,000 ; either by death or mutilation Europe was deprived of at least 25 millions of its best wealth-producers ; and the whole of the delicate and complicated machinery of international trade was shattered.” There is much truth in this. The pre-War debt of the belligerents was £7,300,000,000, and in 1923 it amounted to £49,000,000,000. The world's indebtedness in the same period, as will be seen from the following table, has increased from £8,800,000,000 to £53,800,000,000, and the direct gross cost of the War to the belligerents was, from a study of their budgets, £47,000,000,000. It is interesting to compare the growth of 22 chief countries during the last half a century when the public debt of these countries has increased by £45,700 millions, or more than 12 times. It would have been madness to assume, ten years ago, that

PUBLIC DEBT OF THE WORLD *

(All Countries, including Belligerents)

Years.	No. of Countries included.	Public Debt (Million £).
1713	4	119
1763	4	283
1793	10	610
1816	12	1,649
1848	18	1,719
1870	22	3,741
1889	24	5,827
1900	25	6,263
1913 (pre-War year) . .	33	8,805
	25 †	7,877
1922 or 1922-23 . . .	37	53,759
	25 †	50,313

* For detailed figures see Table XXV., App.

† Same countries as in 1900.

the British House of Commons would actually pass votes of credit for the financing of the War to the extent of £8,742,000,000. In Great Britain the ratio of debt to revenue has increased from 3·6 in the pre-War year to 9·3 in the post-War period; from 1·6 to 5·6 in the case of the United States; from 6·9 to 11·9 in France; 5·1 to 6·6 in Italy; from 2·0 to 5·7 in Germany; and 2·1 to 6·3 in the case of Canada. In India the ratio has remained stationary at 3·6, and in Japan it has fallen from 4·5 in the pre-War year to 2·6.¹ About two-thirds of the cost of the War to Great Britain and the United States were financed from loans and the remainder from taxation. In the great French War, which ended in January 1817, not far short of two-thirds of the cost of the War was met by Great Britain from taxation and the remainder by loans. These large increases in public debts have not been confined to states. Local indebtedness has in recent years increased at a rapid pace, in some cities almost at a rake's progress. The increase in the debt of local authorities has been specially noticeable in Great Britain, the United States, France, and Italy, owing to the extension of administrative functions by local authorities and to some extent by the larger amount of wealth seeking investment. The debt of the city of Bombay, for example, has increased from

¹ Table XXVIII., App.

Rs.486 lakhs in 1904-5 to Rs.649 lakhs in the pre-War year (1913-14), Rs.769 lakhs in 1918-19, and to Rs.1854 lakhs in 1924-25. The "net loan" debt (*i.e.* gross debt less accumulated sinking fund) was budgeted at Rs.1566 lakhs in 1924-25, of which Rs.698 lakhs were on water works. In the United States as well as Great Britain similar instances could be given.¹ There is continual necessity for financial supervision to prevent the piling up of Government loans, and in regard to local loans Central control is also essential. In some ways these huge debts have changed the attitude of financiers and public men generally towards the question of public debts. The real principles have not been radically changed, but many lessons have been learned, often at great expense, during the War.

2. THE ORIGIN OF PUBLIC DEBT

National Debt is the debt which a State owes to its own subjects or to the nationals of other countries. Such debts came into being on the decay of the older method of State hoards. The tendency in early times and in primitive conditions where commerce and industry are undeveloped is to hoard. When trade develops Governments provide only what is required for current expenses, and to meet extraordinary emergencies extraordinary means of raising funds are employed as in the late War. In one of the premier native States of India to-day the ruler's private treasury contains coin and bullion worth more than Rs.10 crores,² and certainly not less. His jewels were valued privately on his accession, and in the opinion of merchants ("saukars") their value was not less than Rs.200 crores. In a native State in Rajputana there are in the State reserves over Rs.3 crores in coin and bullion, in addition to a private treasury containing Rs.2 crores. In another jewellery worth about Rs.2 crores is on view, and what is not shown to the public is probably much greater. Hume also reminds us that "it appears to have been the common

¹ In many cases works have been undertaken which are not urgent. Estimates and plans for capital account are not always prepared in sufficient detail, and a programme five years in advance is sometimes not prepared. Deviations are allowed to take place without justification and often without proper financial control.

² A crore is ten millions. Accordingly Rs.10 crores = £6·7 millions and Rs.200 crores = £133·3 millions.

practice of antiquity to make provision during peace for the necessities of war, and to hoard up treasures beforehand as the instruments either of conquest or defence ; without trusting to extraordinary impositions, much less to borrowing in times of disorder and confusion ". He refers to the large hoards of Athens, the Ptolemies and other successors of Alexander, and says : " We learn from Plato that the frugal Lacedemonians had also collected a great treasure ; and Arrian and Plutarch take no notice of the riches which Alexander got possession of on the conquest of Susa and Ecbatana, and which were preserved, some of them, from the time of Cyrus. If I remember aright, the Scripture also mentions the treasure of Hezekiah and the Jewish prince ; as profane history does that of Philip and Perseus, kings of Macedon. The ancient republics of Gaul had commonly large sums in reserve. Every one knows the treasure seized in Rome by Julius Caesar during the civil wars, and we find afterwards that the wiser emperors, Augustus, Tiberius, Vespasian, Severus, etc., always discovered the prudent foresight of saving great sums against any public exigency." ¹ Before the War Germany kept a hoard at Spandau of £6,000,000 in bullion, and a larger sum was invested in high-class securities. Even a hoard of £25,000,000 is of little use in these days when Great Britain alone was spending towards the end of the War daily £6 or £7 million sterling.

The system of public borrowing, according to Blackstone, originated in the State of Florence about 1344. " Government then owed about £600,000, and, being unable to pay it, formed the principal into an aggregate sum, called metaphorically a mount or bank, the shares whereof were transferable like our stocks, with interest at 5 per cent, the prices varying according to the exigencies of the State." Holland, however, is usually credited with being the first to contract a debt system on systematic lines. Great Britain followed her example. The Bank of England was founded by a Scotsman, William Paterson, in 1694, and its advances to the State are the oldest part of the public debt, a debt that was not formally recognised until 1701.² Adam Smith reminds us that " the same commercial state of society

¹ David Hume, *Essays*, " Essay on Public Credit " (London : Ward, Lock & Co.).

² Thorold Rogers, *The First Nine Years of the Bank of England*. The loan was £1,200,000.

. . . produces in the subjects both an ability and an inclination to lend".¹ To-day countries keep funds in bullion mainly, if not entirely, for currency purposes. They depend for supplies on taxation and on modern credit facilities. Adams is not quite correct when he believes that systematic borrowing "seems to be capable of wide acceptance only among people whose labour is of a high grade of efficiency and who have developed for themselves representative government".² Were this a correct statement of fact it should be applicable to Asiatic countries, but it is, for example in the case of India, not true. India's borrowings have, for at least over a century, been sound and systematic without these conditions.

3. THE PECULIARITIES OF PUBLIC DEBT

The practice of borrowing to-day has many points of similarity with that in vogue in the time of William and Mary in England. The causes are the same : (1) temporary requirements ; (2) sudden emergencies such as war ; and (3) especially in new countries the construction of public works which could not be undertaken if the whole burden were to fall on the year's revenue. There are one or two peculiarities of State borrowing that require emphasis. The rules that govern borrowing on the part of an individual are generally similar to those of the State. The State, however, can compel the taxpayer to supply it with funds, and these funds are anticipatory in the sense that they have to be subsequently met out of future revenue. Secondly, a State cannot retrench quite so effectively as the individual, although the Geddes Committee in Great Britain and the Inchcape Committee in India show to what extent retrenchments can be undertaken. A State does and can retrench when confronted with deficits, and when the proceeds of new taxes are not readily available. This should be considered to be as practicable as borrowing. It is true there are commitments like the Army and the Civil Service which preclude the cutting down of expenses in the manner which a commercial firm can follow. Nevertheless, when retrenchment is seriously considered, it is surprising what can be done in this respect.³ Thirdly,

¹ *Wealth of Nations*, Book V. chapter iii.

² Adams, *Public Debts*, 1888.

³ *Vide* Book II. Chapter III. p. 29.

a State may repudiate its debts by act of the legislature.⁴ It rests with the State to say whether or not its obligations will be met. The classic instance in recent years is Russia, which before the Revolution was indebted mainly to Great Britain and France, and to a less extent to the United States, Japan, and Italy. Before the War certain States of Central and South America repudiated their debts. All wise Governments realise how delicate credit is. Anything likely to shake the credit of a country must be sedulously eschewed. In the London money market early in 1924 the Government of Queensland, by the results of the Land Act Amendment Act, 1920, so damaged its credit in the eyes of the London money market that the flotation of large public loans was impossible. The Bill removed the restriction placed in a previous Act on the increase of rents. Under the new Act rents were increased in some cases by several hundreds per cent, and with retrospective effect. It appeared to be forgotten that a strict fulfilment of a contract is the foundation of credit. The principle of the sanctity of contracts is not more lightly thought of in Queensland than elsewhere, and it now appears that the source of the difficulty was rather an error of judgment than an error of principle. It illustrates the very great necessity of a Government, even in the comparatively high position of Queensland, of realising the importance of strictly conforming, in the matter of public finance, to the usages of the money market.

4. THE MERITS AND DEMERITS OF PUBLIC DEBT

A public debt affords a convenient form of investment. The interest on an internal public debt is paid from one portion of the community to another. The proceeds of public loans are paid over to Government, which spends the amount, and the income of those who hold the debt is derived by means of taxes from the property and industry of others. "The property of the public creditor", writes Blackstone, "consists in a certain portion of the national taxes; by how much, therefore, is he richer by so much the nation which pays taxes is the poorer." It must, however, be remembered that the interest-receiving classes are frequently, if not usually, the interest-paying classes. While the payment of interest on foreign debt reduces, *ceteris paribus*, the net income of the debtor country by transferring a part of its

income abroad, the payment of interest on internal debt has no such effect. The country's national income is the same whether the interest on internal debt is left with the taxpayers or is taken from them and paid out as interest on War loan. It is a round-about way of taking money out of one pocket and putting it into another of the same taxpayer. The payment of interest on War debt does not affect the productive capacity of the country as a whole, but there may be indirect effects on production. Dead-weight debt is not a creation of wealth, but as McCulloch reminds us, "the integrity and increase of our Dominions, the protection of our rights and liberties, and our triumphs by land and sea, are the real equivalents of the public debt and of all the blood and treasure we have spent in warlike enterprise, and they are quite as ample and conduce as much to our prosperity as a nation as if they had been realised in an increase of population and wealth ; no sacrifices can be too great that are required to preserve national security and independence, and a loan expended on armies or fleets employed for such a purpose is quite as well and profitably employed as if it had been laid out on agriculture, or in promoting manufactures or trade". Another advantage of a public debt is that it tends to encourage the establishment of banks. Trade nowadays follows the bank as well as the flag. In exceptional circumstances it may be necessary for the State to borrow, and this may, as in the late War, when the loans were spent quickly on munitions, be a stimulus to industry. In times of rising prices it is extravagant to accumulate debt, as interest as well as principal may have to be paid in a period of lower prices. In a period of falling prices an increasing proportion of the money income of a country is required to meet interest and the repayment of the principal. With falling prices money incomes are reduced and the taxable capacity of the country, measured in terms of money, is also reduced. Profits fall off and reduce incomes. If Governments do not raise loans from savings, and if they do not obtain revenue by taxation, they may create new purchasing power by inflation. This surreptitiously decreases the purchasing power in the hands of the taxpayer as prices rise, and there is a fall in values all round. The following table shows the effect of inflation on national debt :

GERMANY

	Marks to the £.	Debt (millions of marks).
31st March 1914 . . .	20.43	4,918
30th June 1921 . . .	280	292,659
30th June 1922 . . .	1,394	375,993
30th June 1923 . . .	711,775	24,990,423
30th September 1923 . .	723,187,500	46,844,781,444

Inflation acts like a tax in one respect. It reduces the real income of the individual without giving a claim for repayment. The rise in prices is seen in the following table :

INDEX NUMBERS OF WHOLESALE PRICES

(1913 or 1913-14 = 100)

	Year.	Index No.
Great Britain	1924	166
India	1924	185
Canada	1924	165
Australia	1923	179
New Zealand	1923	175
South Africa	1923	126
U.S.A.	1924	151
France	1923	419
Italy	1924	574
Japan	1924	210

The purpose of the debt is important, and this is a point which Adam Smith overlooked in condemning public debts. The contraction of debt by the State does not mean that capital is destroyed or that it is unprofitably invested. It is advantageous, especially for undeveloped countries, to have more capital for development purposes. Before the War, in India, 85 per cent of the National Debt was productive, and only 15 per cent dead-weight or unproductive. The unproductive portion was reduced to 12 per cent in 1917. On 31st March 1924 the percentages were respectively 68 and 32. Were capital not imported the national income would be lower, it being assumed that this capital is productive and able to pay a return on capital in addition to the amount spent in wages and on works generally. It is sometimes said that public debts tend to make more permanent the differences

between the interest-receiving and the interest-paying classes, and in this respect are open to a social objection. We have already shown that these two classes are not so distinct as is often imagined, and the argument is not of importance. The political objection is stronger, viz. that the incurring of public debts by States tends to remove a check, noted by Adam Smith, on the Government. The country does not realise the full effects of the Government policy as it would do under taxation.¹

What, then, should be the general principle in the raising of loans? It is to raise as much taxation annually as the nation can bear, and to defray extraordinary or abnormal expenditure as far as is possible from this source. The great advantage of a tax, as compared with a loan, is that the former never leaves any charges behind it in the form of repayment of principal to disturb subsequent Budgets. Even in the War, Mr. McKenna, when Chancellor of the British Exchequer, laid it down that taxation should meet all ordinary or normal expenditure plus the charges for interest on debt, a very high ideal. Taxation should be preferred to loans if commerce and industry are not prejudicially affected by the increased taxation. Loans, on the other hand, are necessary to avoid too rapid an increase of taxation. Some systems of taxation are more easily adjusted to increasing expenditure than others. An unsatisfactory taxation system may render it almost impossible to increase taxation, and times of peace should be chosen to overhaul the machinery. At the same time, no time should be lost to prevent a debt from consuming a very large part of the revenue. In April 1923, for example, the French debt stood at 290 billion francs, and allowing for the depreciation of the franc in estimating foreign debts, the total was 360 billion francs; and in the next six years an addition of 44 billions is anticipated, or a total approximately of 420 billion francs by 1930. At 5 per cent this means in interest alone about 21 billion francs, or nearly the entire present revenue. Montesquieu² and Adam Smith³ emphasise that the State cannot add to its

¹ "When the pressure of the war is felt at once, without mitigation, we shall be less disposed wantonly to engage in an expensive contest, and if engaged in it, we shall be sooner disposed to get out of it, unless it be a contest for some great national interest" (*vide* Ricardo, "Essay on the Sinking Fund", p. 539, McCulloch's edit. of his *Works*).

² *De l'esprit des lois*, 1748, Bk. XXII., especially chapters xvii. and xviii.

³ *Wealth of Nations*, Book V. chapter iii.

liabilities without coming to the end of its resources, as 'in the case of the individual citizen. Hamilton,¹ Ricardo,² and Nebenius³ emphasise the great importance of taxation over loans in a State's finance. All of these would have, to a very great degree, agreed with David Hume in regard to the incurring of debt when he declined "to waste time in declaiming against a practice which appears ruinous beyond all controversy".

5. THE DIFFERENT FORMS OF PUBLIC DEBT

The classification of public debts or loans is not uniform. The expressions voluntary and involuntary or forced loans, internal and external loans, productive or reproductive, deadweight or unproductive debt, funded, unfunded or floating debt, and annuities of various kinds are current in financial literature. The terms "Funding System" and "Sinking Fund" also require definition.

In the seventeenth century, especially in England, forced loans were levied. Such loans lack the advantages of both voluntary loans and taxation. A voluntary loan is the only loan which procures funds, being issued on strictly business principles. Nothing appeals to the generality of men as self-interest. The advantage of a loan is that the investor pays just as much as he wishes. The advantage of a tax is that there is no repayment, and therefore no provision is necessary in future Budgets. Internal loans are loans held by nationals within a country. The payment of interest on internal debt does not, as we have seen above, affect the national income, *ceteris paribus*; it is merely a redistribution of income, and the money may be left with the taxpayer or taken from him and paid out again as interest on public debt. External debt means the transfer of wealth from the lending to the borrowing country when the loan is made, and a transfer in the reverse direction when interest is periodically paid or when the principal is repaid. With external or international debts part of the income of the debtor country has to be

¹ *Enquiry concerning the Rise and Progress, the Redemption and the Present State and Management of the National Debt of Great Britain* (Edinburgh, 1814, Oliphant, Waugh & Innes).

² "Essay on the Funding System", *Works* (McCulloch's edition).

³ *Der öffentliche Kredit*, 1820.

transferred to the creditor country in payment of interest or principal, and the payment of this reduces the *net* income of the paying or debtor country by the transference of part of its income abroad. Had the capital not been used by the country for development of railways, irrigation works, etc., its income would have been less than it would have otherwise been. To repay an external debt or to pay the interest the debtor country raises revenue by taxation, borrowing, or inflation. Taxation may be difficult owing to lack of organisation of the financial system. Inflation will lead to further inflation, and will fall so heavily on the poorer classes of the debtor country as to affect the standard of comfort. There are also exchange difficulties which such payments not infrequently produce. The debtor country exports goods or exports gold to meet such claims. In short, there are larger exports or sales abroad and smaller imports as the result of the payments by the debtor country. Productive or reproductive loans are debts which are fully covered by assets of equal or greater value. The source of the interest is the income from the ownership of these as railways or irrigation works. Dead-weight or unproductive debts are those which have no existing assets. War is the chief cause of unproductive debt, and to a much smaller extent Budget deficits. Funded debt is a debt which is repayable (*i.e. compulsorily* repayable) at a distant date, and for the payment of interest on which regular provision is made. Unfunded or floating debt¹ is the opposite of funded debt, and is debt repayable within usually 3, but also 6 or 12 months, such as Treasury Bills and the Ways and Means advances from the Bank of England to the British Government in anticipation of revenue payable at a later period. The dividing line between funded and floating debt may in ordinary financial parlance be said to be the period of a year. In English official publications unfunded or floating debt is used in a restricted sense. Funded debt in these accounts means debt the principal of which will never be repaid, and unfunded debt is debt the principal of which must be repaid not later than some fixed date in the future. Thus consols belong to the former class, and to the latter all other British debt and the debt of local authorities. This distinction is out of date and exasperating. The British Funding Loan of

¹ Floating debts are unfunded, but all unfunded debts are not floating debts.

1919, repayable in 1960 at the earliest, and in 1990 at the latest, would be included under unfunded debt. The disadvantage of floating or unfunded debt is that when the bills fall due it might be difficult to pay them off or to renew them, especially in a financial crisis. This form of debt might entail borrowing on less favourable terms, and may lead to further inflation. Tax-free loans are to be avoided, since these hamper Finance Ministers and complicate the tax system. In Great Britain there is only one tax-free loan.¹

Governments often borrow money upon annuities. For a certain sum advanced on loan, Governments undertake to pay a specified sum for a term of years. It may be paid over a certain period, 10, 20, or 100 years, or for a certain period when it is called a contingent annuity. A life annuity is one determined by the duration of one or more lives. A deferred or reversional annuity is one that does not commence until after a certain period of years or after the decease of a person. An annuity in possession is one that has already commenced. Tontines, named after the inventor Tonti, an Italian banker of the seventeenth century, are annuities shared by subscribers to a loan with the benefit of survivorship, the annuities being increased as the subscribers die, until at last the whole goes to the last survivor or to the last two or three according to the terms of the tontine. A Mr. Martin who was nominated a subscriber to a tontine of 1777 and died in his 92nd year, in return for £100 originally contracted, received as dividend for the preceding six months in January 1870, £3875 : 0 : 4, and in July 1870, £3891 : 10 : 2. The amount originally borrowed by the British Government was £228,000 at 7 per cent. The principal of each subscriber (£100) lapsed at death, while the entire interest was divided among the survivors. Consols owe their origin to the passing of an Act of Parliament in 1751-52, when five different loans and certain annuities were consolidated into one stock of 3 per cent annuities. The interest was payable out of the sinking fund from June 1752. Exchequer bonds, Treasury bills, and war savings certificates are dealt with in the chapters on the "History of Public Debts".

The favourite expression of nineteenth-century writers on British finance, the funding system, means the system of creating funded debt, *i.e.* debt raised for permanent purposes, repayable

¹ See Chapter XXXV. p. 502.

at a distant date or not repayable at any definite date. A sinking fund is the fund formed by a regular annual provision over and above the interest charges, for the purpose of forming a fund which would repay the debt.¹ The sinking fund was, as explained in Chapter XXXV., discredited in eighteenth-century British finance, owing to illusory schemes put forward by many writers on finance. It is necessary for the creation of a real sinking fund to invest from taxation a given annual sum, and to accumulate all interest on such sums for the same purpose.

6. THE FLOTATION OF PUBLIC DEBT

When loans are floated they should be so arranged as to cater for the wants of various classes of investors. The amount for each class should be large enough to make the security readily negotiable and marketable. The stock should be issued as near to par as possible, with interest at the current rate rather than at a lower rate of interest with the stock considerably below par. There may be occasions, however, when it may be advantageous to the State to keep the immediate charge of the loan as low as possible. Investors accepted a low rate of interest before the War when they saw their stock clearly appreciating in value. In view of the increase in the capital of the debt by issuing the stock below par and a low rate of interest, it is desirable to issue the stock at the current rate of interest with the stock at par or at as near par as practicable. In English financial history of the eighteenth century, low interest and high nominal capital predominated, because (1) people believed in the efficacy of the sinking fund, and (2) the State was not supposed to borrow beyond 5 per cent in view of the restrictions on usury. There are various ways of keeping in close touch with the money market. A Finance Minister may first of all sound the State bank and other bankers. He may make an offer through them or a group of capitalists. Rates of commission to brokers, insurance agents, and others are frequently paid at a higher rate on the opening of the loan, and fall to a lower rate as the date of closing of the loan draws near. Sometimes in the last week in which the loan is opened little or no commission is paid. Tenders are sometimes called for, as was,

¹ An example of the use of the sinking fund will be seen in Table XXX., App., on the British debt to America.

for example, customary in regard to the sale of Council drafts on behalf of the Secretary of State for India. At the risk of wearying the reader with many repetitions, it is again advisable to emphasise the importance of promptly liquidating debt. Nothing enhances a country's credit as this does at all times.

CHAPTER XXXIV

THE BURDEN OF PUBLIC DEBTS

IN the previous chapter a distinction has been made between dead-weight public debt and productive public debt. Internal loans for the purpose of creating public assets, the yield of which is sufficient to cover loan charges, is no burden on the community. At the same time a caveat was necessary when, in dealing with capital expenditure, we emphasised the importance of realising the advantages of straightforward taxation, so that in the long run there is a positive gain to the community from its having been obliged to save to pay the taxes required. The principles underlying the use of loans for railways, irrigation works, and other enterprises repayable within a period of years have been set out in Chapter XI. Governments in peace time frequently contract loans abroad when they are unable to develop the natural resources by internal loans. There are numerous instances of this, *e.g.* Canada, India, Australia, and Argentina. In the Great War some countries financed their imports by external loans, and others since the War, notably Austria, have attempted to re-establish their currency systems by contracting external loans. It is the aim of the present chapter to examine these questions a little further, with special reference to the burden of debt.

1. METHODS OF ESTIMATING THE BURDEN OF PUBLIC DEBTS

There are various ways of estimating the comparative burden of public debts. One method, and perhaps the most common, is to compare the nominal capital of the debt in various countries. Thus, in the following table, the public debts of Great Britain,

the self-governing Dominions and India, the United States, France, Switzerland, Belgium, and Japan are set out :

	Total Capital of Debt (£ Millions).*		
	1900.	1913 (Pre-War Year).	1923.
Great Britain	629	706	7,766
Canada	55	69	500
Australia	204	335	923
New Zealand	48	92	219
Union of South Africa .	..	126	180
India	226	307	585
The United States . .	259	245	4,715
France	1086	1315	11,472
Switzerland . . . . .	..	68	148
Belgium	105	148	784
Japan	53	272	323

* *Vide* detailed table (No. XXV.), App.

This does not show the actual, but the nominal value of the debt, and it does not take into consideration the interest paid on borrowed capital. The rate of interest or the total interest charges are sometimes compared. Some countries pay a high rate of interest, others a medium or low rate, and yet others an abnormally high rate.¹ The United States, for example, borrows at a much lower rate of interest from its nationals than does France, which before the War had the largest debt in the world. France in recent years has issued loans considerably under par, and this has to be remembered in arriving at the real, as opposed to the nominal, rate of interest. The method of comparing the nominal capital of the debt leaves out of account the nature of the debt. Is it dead-weight or productive debt? In the table above, for example, out of £585 millions (Rs.877 crores) of India's national debt, £385 millions (Rs.578 crores) are productive.

A second method is to take the *per capita* debt. *Per capita* interest charges are small and are seldom taken. The following table shows the *per capita* debt for certain countries of industrial importance :

¹ *Journal of the Royal Statistical Society*, vol. xxxvii., 1874, "The Recent Progress of National Debts", by Dudley Baxter. Baxter's groupings of countries are instructive and afford an interesting comparison with those at the present time.

	1900.	1913 (Pre-War Year).	1923.
	£ s.	£ s.	£ s.
Great Britain	15 8	15 10	174 2
India	17	1 5	2 7
Canada	10 8	9 0	55 10
Australia	53 14	64 10	165 15
New Zealand	58 12	91 10	162 16
South Africa . . . . .	..	88 10	116 19
The United States	3 8	2 10	42 6
France	28 4	34 4	356 0
Germany	2 2	16 3	159 10
Japan	1 4	3 13	4 6

The growth of population, the increase in wealth, and public assets available for liquidation have to be remembered in comparing one year with another and one country with another.

A very useful method as a basis of comparison is the annual debt charges in their relation to national income. If the *per capita* figures alone are taken, the relative income and wealth of the two countries are omitted. Great Britain's *per capita* national income is eleven times that of India's. Great Britain's wealth is about £20,000 millions, while that of India may be estimated at Rs.15,000 crores or £10,000 millions.¹ The wealth of the United States has been estimated ² at \$355,000 millions or £72,900 millions, of France 1,200,000 million francs, of Italy 611,000 million lira. If the debt of these countries is compared with their respective wealth, the percentages are as follows: Great Britain, 39 per cent; France, 24 per cent; Italy, 18 per

¹ This figure for India has been estimated at Rs.15,000 crores or £10,000 millions. In the estimate of Rs.15,000 crores or £10,000 millions are included real property (land and buildings), railways, gold and silver coin and bullion, jewellery, agricultural products, live stock, manufactured products, minerals, imported merchandise, manufactured machinery and tools, telegraphs, telephones, tramways, and miscellaneous. Sir Robert Giffen's rough estimate of £3000 millions was made in 1903 (*Economic Enquiries and Studies*, vol. ii., London, Bell & Sons, 1904). Since Giffen's estimate was made prices have risen, and with increased development, especially since 1904-5, there has been an increase in wealth (see Table XXXII. App.). Cf. Professor Corrado Gini's article, "Quelques chiffres sur la richesse et les revenus nationaux de quinze États" (*Metron*, vol. iii. N. I. 1, vii. 1923). The wealth of India is given at 150-185 milliard francs (£6000-£7000 millions at 25 fr. = £1).

² Cf. Fisk, *Inter-Ally Debts*, p. 282 ff., where the wealth of France, Italy, and the United States has been given. The figure for Great Britain is that generally accepted, £20,000 millions; cf. Stamp, *Taxable Capacity*, p. 38. Fisk's estimate is £22,000 millions (*Inter-Ally Debts*, p. 272).

cent; and the United States $6\frac{1}{2}$ per cent, and India 6 per cent.

The proportion of annual State expenditure spent on debt is also a useful index of the burden of debt. The following summary table is of interest :

PERCENTAGE OF EXPENDITURE ON DEBT SERVICES TO TOTAL
ORDINARY EXPENDITURE

Country.	Pre-War Year.	Post-War Year.
France	13.5	53.8 (1924, estimated)
United States	3.2	44.2 (1921-22)
Great Britain	12.2	39.0 (1923-24)
Switzerland	8.9	38.6 (1924, estimated)
New Zealand	23.5	33.8 (1922-23)
Canada	10.9	33.5 (1921-22)
Belgium	27.1	31.8 (1923, estimated)
Holland	16.4	30.6 (1923, estimated)
Union of South Africa .	38.8	28.6 (1920-21)
Australia . . . . .	..	23.8 (1922-23)
India	12.2	15.0 (1921-22)
Japan *	36.9	18.4 (1921-22)

* *Vide Financial and Economic Annual of Japan*, 1923, p. 36 (Department of Finance, Tokyo). Amount transferred to National Debt Consolidation Fund and Interest on Deposits and charges for payment.

Other methods have been suggested by various writers on public finance, such as a comparison of the actual or market value of the debts. The market price refers only to a small amount of the total debt that is in the market for sale. A comparison based on the relative proportions of internal and external debt is also difficult.

The conclusion is that, all things considered, not one method alone should be adopted, but a combination of the various methods. Probably the most useful are the methods of (1) taking the ratio of national debt to national wealth and income, and (2) the percentage of expenditure on the debt service to total ordinary expenditure. Since the World War an inconvertible paper currency, and not gold, has been the local measure of value in all countries, except in the United States and Japan. In a comparison of post-War debts with pre-War debts the rise in prices and the depreciation in the value of gold,¹ a depreciation which

¹ To calculate the depreciation of gold it is usual to take the difference between the actual price of gold and the price as it would be according to the

is in the neighbourhood of 40 per cent, have accordingly to be considered.

2. GENERAL CONSIDERATIONS ON THE BURDEN OF PUBLIC DEBTS

In regard to the remarks above¹ on internal and external, productive and unproductive debts, some general principles have still to be examined. An internal debt results, as has been shown, in transfers of wealth within the country, and to judge of the direct burden the effect produced by the debt on incomes has to be considered. If there is greater inequality of incomes the direct burden increases, if less inequality the direct burden is less. It cannot be said how much of an individual's wealth paid in taxation goes to pay debt charges, but it may safely be assumed that it is similar to the relation which debt charges bear to the total expenditure, already referred to above. The distribution of taxation² and the distribution of public securities among the various classes of the community³ require examination. If the rich pay in taxes proportionately less than the proportion of public securities held by them, then there will be a direct real burden. One writer, after pointing out that "there can never be any direct money burden or direct money benefit of an internal debt, for all the money payments cancel out", aptly summarises the position thus, "The debt will involve a direct real burden or a direct real benefit to the community, according as this series of transfers from taxpayers to public creditors increases or decreases the inequality of incomes. . . . If the British debt consisted exclusively of savings certificates held by wage-earners, and if

rise in the price of commodities. Thus the price of gold in Bombay in July 1914 was Rs.24-10-0 per tola, and in January 1924, Rs.25-12-0. The index number of wholesale prices of commodities had risen in the same period to 188. The price of gold, if there had been no depreciation, should have been in January 1924 $\frac{\text{Rs.24-10 } 0 \times 188}{100}$ or Rs.46-4-9. The difference between Rs.46-4-9 and

Rs.25-12-0 represents the depreciation of gold—a fall of 44·4 per cent.

¹ Chapter XXXIII. p. 474.

² See the data on direct and indirect taxation and Chapters XVII. and XXV.

³ The *Economist* of 19th April gave an analysis of the British debt which showed that out of £7700 millions £2250 millions or 31 per cent were held by private individuals, £1108 millions or 14 per cent by foreign Governments, and the rest, £4242 millions or 55 per cent, by British public companies and trusts.

British taxation consisted exclusively of income tax and death duties on the wealthy, the British debt transactions would involve a large direct real benefit to the community. But the actual facts are very different from this, both in this country and elsewhere." He concludes that there is almost always a direct real burden, because public securities are held mainly by the wealthier classes, and progressive taxation is not likely to be "so sharply progressive as to counterbalance, among the wealthier classes, the income derived from public securities".¹ The Colwyn Committee appointed by the British Chancellor of the Exchequer is, it is understood, examining as far as is statistically possible the facts underlying this conclusion. This Committee will also examine indirect burdens, *e.g.* the extent to which the present rate of taxation is, if at all, checking the productive powers of commerce and industry by reducing the savings of the taxpayer in business and also, what is important, his desire to save. A similar indirect burden of high taxation to meet debt charges takes place when expenditure on education, often disgracefully insufficient except in Western Europe, is cut down in view of the expenditure on debt, an economy which in the long run may reduce production.

In regard to external debts, it may be said that the direct money burden of external debts is the money payments that have to be made for interest and the repayment of principal, while the direct real burden is the net loss to the debtor country in economic welfare by these payments. If the contributors are mainly the rich the direct real burden will be less than if they were the poor. The necessity, however, of distinguishing between dead-weight and productive debt should not be lost sight of. The indirect burden of an external debt would arise if, owing to the payments regularly made, there was a check to the productive capacity of the community. In the dead-weight debt to the United States, for example, Great Britain has to raise taxation to meet interest and sinking fund charges. This, together with any check to public expenditure on essential social services, would be an indirect burden. As compared with internal debt the burden of external debt is greater, because in the case of internal debt interest charges and the repayment of principal are paid within the country, and result in a mere

¹ Dalton, *Public Finance*, pp. 191-192 (London: Routledge, 1923).

transference of wealth from one section of the community to another, and the taxpayer and the receiver of interest are often the same person. In the case of external debt money is paid to those living abroad, frequently, as in Canada and other countries, for the loan of capital used productively, and this is a greater burden than that of internal debt. The contracting of dead-weight debts when prices were high makes the direct real burden all the heavier as prices and the rate of interest fall. The payment of interest, expressed in terms of wealth, increases with the fall of prices, and therefore its payment from taxpayer to creditor is in effect larger, and the burden of the debt is increased. With the fall in interest the value of these War securities, *ceteris paribus*, rises, and therefore the burden of repayment of principal from taxpayer to creditor expressed in real wealth is also increased. Hence the burden of the debt. This has already been referred to in the previous chapter.

The remarks in the previous paragraph should not overlook the importance of raising loans for productive purposes. There are no limits to the field before capital, and one has only to remember the advice of Alexander Hamilton, Secretary of the Treasury in Washington's Cabinet at the early age of thirty-two, in his famous *Report on Manufactures*,¹ which was the inspiration of List.² Hamilton had a positive genius for Public Finance, and he showed his countrymen how necessary foreign capital was for development. He described the objections to foreign capital as the fruit of unreasoned jealousy. It was essential to the encouragement of industry. There were, of course, dangers, as, for example, when it led to exploitation and the strangling of competition, but this, he rightly believed, could be avoided.

¹ 1791. Hamilton's *Works* (H. C. Lodge), vol. ii. (New York, 1904).

² 1789-1846. *Das nationale System der politischen Oekonomie*, 1841 (National System of Political Economy), translated by S. S. Lloyd (Longmans, Green & Co., 1916).

CHAPTER XXXV

THE HISTORY OF PUBLIC DEBT—GREAT BRITAIN

I. SCOPE

IN this and the subsequent chapter it is proposed to review some of the more important features in the history of public debts of various countries. A little history is sometimes a dangerous thing. It will, therefore, be all the more necessary to examine with care the main statistics on public debts without bewildering or distracting the inquirer regarding the broad facts that have to be understood. A long ramble through exceedingly rough country may be unavoidable. In the first place, the history of the British Public Debt will be reviewed with special reference to the fallacy of the sinking fund, a fallacy that is apt to appear at critical periods in other countries, notwithstanding the writings of Hamilton and Ricardo in exposing the absurdities of Pitt's sinking fund. The debt, the main legacy of the War, has grown from £706 millions before the War to £7766 millions at the present time. At the Armistice the debt was £7367 millions more than in August 1914. This is an enormous sum as compared with the wars of William III., which added £15 millions to the public debt, the wars of Anne £38 millions, the Seven Years' War £58 millions, the American War £116 millions, and the French War £613 millions (the first period an increase of £266 millions and the second period an increase of £347 millions). The financing of the Great War by borrowings on the part of Great Britain, the self-governing Dominions, and India will also be reviewed. Great Britain followed the principle from 1916, as has been shown,¹ that its Budget should

¹ Chapter XXXIII.

provide for all normal expenditure and the War Debt charge—a standard then higher than that aimed at by any other belligerent. Great Britain and Australia paid from one-fourth to nearly one-third of the War expenditure by taxation. The United States paid even a higher proportion, namely one-third, a contrast with France, where the percentage is a shade under 17 per cent. A survey of the public debt of India will show the importance of productive and unproductive debt, and the advantages in certain circumstances of an external debt. The history of debt in France, and to a less extent that in Italy (both of which have not yet paid even the interest on foreign debt), show the peril of overborrowing and the necessity of budgetary equilibrium for the restoration of sound financial conditions. A balanced Budget raises the price, *ceteris paribus*, of a country's securities, enhances credit, prevents inflating prices, and makes a beginning possible with reduced taxation. The experience of Japan in the Great War in preventing a large increase of debt, and in the distribution of her borrowings externally and internally, is instructive. Finally, the procedure in the United States in regard to the flotation of the large Liberty Loans and the soundness of the principles followed, not to mention the War Loan publicity campaigns, will also be reviewed.

2. THE BRITISH PUBLIC DEBT

Among the many lessons that we have learned and are learning as a result of the War, one of the most fruitful in its effects on financial recovery is the general conviction that States must free themselves from the paralysing clutch of borrowing to meet their everyday expenditure. All ordinary expenditure, including the interest charges on debt, should be met from taxation and not from loans. Only in exceptional circumstances must large borrowings take place. "The want of parsimony", said Adam Smith, "in times of peace, imposes the necessity of contracting debt in time of war. When war comes, there is no money in the treasury, but what is necessary for carrying on the ordinary expense of the peace establishment. In war an establishment of three or four times that expense becomes necessary for the defence of the state, and consequently a revenue three or four times greater than the peace revenue. Supposing that the sovereign should have, what

he scarce ever has, the immediate means of augmenting his revenue in proportion to the augmentation of his expense, yet still the produce of the taxes, from which this increase of revenue must be drawn, will not begin to come into the treasury till perhaps ten or twelve months after they are imposed. But the moment in which war begins, or rather the moment in which it appears likely to begin, the army must be augmented, the fleet must be fitted out, the garrisoned towns must be put into a posture of defence ; that army, that fleet, those garrisoned towns must be furnished with arms, ammunition, and provisions. An immediate and great expense must be incurred in that moment of immediate danger, which will not wait for the gradual and slow returns of the new taxes. In this exigency government can have no other resource but to borrowing.”¹ Countries like Great Britain and the United States realise that any other policy is extremely short-sighted. In Book II. on expenditure, the principles governing a country’s expenditure from capital are discussed,² and it is unnecessary to repeat what has been said in this connection. While signs of improvement have dawned in the financial sky of some countries, others may be said to be trembling almost on the razor-edge of disaster, and the remark of Adam Smith in this case is not irrelevant. “The progress”, he said, “of the enormous debts which at present oppress, and will in the long run probably ruin, all the great nations of Europe, has been pretty uniform.”³

The main features of the British public debt may be summarised briefly in the table below. The increase year by year and the interest charges are shown in the following table.

The debt in 1688 consisted of temporary obligations for arrears due to the Army and for other demands connected with the Revolution. The litigation connected with the Goldsmiths’ claim for reimbursements of the amount seized from them by Charles II. in 1672 was adjudicated at £664,263, and if this is added to the temporary obligations for arrears, £384,000, the figure was over one million sterling at the time of the Revolution. To the reign of William III. the methods of public borrowing now in force may be mainly traced. The influence of Dutch finance at this period was considerable on English finance. The Bank of

¹ *Wealth of Nations*, Book V. chapter iii.

² Chapter XI.

³ *Wealth of Nations*, Book V. chapter iii.

THE BRITISH NATIONAL DEBT

Year.	Event.	Debt (£ Millions).	Annual Charge, including Annuities (£ millions).	Increase of Debt over previous Year in this Table.	
				Net.	Per Cent.
1689	Post-Revolution year. . .	1	·04	..	..
1702	Accession of Queen Anne . .	16	1·3	15	1500
1714	„ George I. . .	54	3·3	38	237·5
1727	„ George II. . .	52	2·4	- 2	- 3·7
1756	Seven Years' War began . .	75	2·8	23	44·2
1763	„ „ ended . .	133	5·0	58	77·3
1775	American War began. . .	127	4·7	- 6	4·5
1784	„ „ ended . .	243	9·5	116	91·3
1793	French wars began . .	248	9·7	5	2·1
1815	„ „ ended . .	861	32·6	613	247·2
1837	Accession of Queen Victoria .	788	29·0	- 73	- 8·5
1854	Crimean War began . .	802	27·4	14	1·8
1857	„ „ ended . .	837	28·6	35	4·4
1899	Boer War began . .	635	23·2	- 202	- 24·1
1903	„ ended . .	798	27·0	163	25·7
1910	Accession of George V. . .	762	21·8	- 36	- 4·5
1914	(1) March 31 . . .	706	24·5	- 56	- 7·4
	(2) Great War begins (Aug.) .	708	24·5	2	0·3
1915	March 31 . . .	1162	22·7	454	64·1
1916	„ . . .	2190	60·2	1028	88·5
1917	„ . . .	4064	127·3	1874	85·6
1918	„ . . .	5921	189·9	1857	45·7
1919	„ (Great War ended November 1918) . .	7481	270·0	1560	26·3
1920	March 31 . . .	7876	332·0	395	5·3
1921	„ . . .	7623	349·6	- 253	- 3·2
1922	„ . . .	7721	332·3	98	1·3
1923	„ . . .	7813	324·0	92	1·2
1924	„ . . .	7766	347·3	- 47	- 0·6

England, founded in 1694, gave better financial facilities than those of the Goldsmiths, and the temporary advances by the Bank at this period are the forerunner of the Ways and Means advances of the present day. The unfunded debt was in the form of tallies, Navy bills, and Exchequer bills. Tallies were wooden sticks given as receipts for money payments.¹ "Tallies of assignment" were sometimes issued assigning definite sources of revenue for the payment of the advance. The holder was entitled to the amount on a fixed date in the future and these

¹ See Anson, *Law and Custom of the Constitution*, vol. ii. p. 310 (Oxford Clarendon Press, London, 1892).

Exchequer orders were transferable by endorsement. In 1696 Exchequer bills took the place of tallies and were issued in even denominations of £5 and £10. They were negotiable when endorsed and they carried interest. They were received by Government in payment of all taxes except the land tax, and when received could be re-issued. In 1707 they were accepted in payment for taxes or any obligation due to Government and exchanged for ready money on demand at the Bank of England. An allowance of $4\frac{1}{2}$ per cent per annum was made at the Bank of England for circulating the bills and the Bank advised the Exchequer as to the amount of bills which should be placed on the market.

The funded debt was, in the early period of its history, in the form of annuities and perpetual loans from the Bank of England, the East India Company, and the South Sea Company, which advanced money in exchange for charter privileges. Reference has already been made to annuities which represent only periodical payments. The grant of a charter to a rival to the East India Company had as its consideration a loan to the State of £2,000,000 in 1698. The amalgamation of the two Companies in 1702 led to a further loan of £1,200,000. The South Sea Company exchanged its stock for the unfunded debt of Government and paid £500,000 in addition in return for trading rights. The attempted conversion of the whole of the debt into the Company's stock and the bursting of the South Sea bubble are too well known to require elaboration.

Lottery loans were first raised in 1694, and during the American War, 1775-1783, the lottery loan became most popular. In 1778, for example, in connection with the loan of £6,000,000 there were 48,000 lottery tickets. Each subscriber of £1000 received an equivalent amount of 3 per cent stock and an annuity for 30 years of £2 : 10s. on each £100, which amounted to $5\frac{1}{2}$ per cent for 30 years together with the privilege of purchasing 8 lottery tickets for an additional payment of £80. At first the prizes, which amounted to the total amount paid for the tickets, were funded and were later on paid in cash to the holders of the winning ticket in the spring of the following year. After 1784 the practice of attaching elaborate lottery schemes to loan flotations was discontinued, but until 1823 a certain percentage of the annual requirements of the Exchequer was provided from the

proceeds of the sale of lottery tickets. In 1824 and 1825 there were no lotteries and in 1826 the last lottery was drawn. Between 1755 and 1826 lottery loans were resorted to no less than 55 times. The net income throughout the period from lotteries (apart from loan receipts) was £12,000,000.

3. THE SINKING FUNDS

In 1716 a sinking fund was established¹ the credit of which belongs really to Earl Stanhope. There seems to have been before this date the rudiments of a special fund for the repayment of certain debts.² It was provided in the Act of 1716 that the surplus of certain duties and funds "shall be appropriated, reserved, and employed to and for discharging the principal and interest of such national debts and incumbrances as were incurred before the 25th December 1716, and are declared to be national debts and are provided for by the act of Parliament, in such manner and form as shall be directed or appointed by any future act or acts of Parliament to be discharged therewith or out of the same, and to or for none other use, intent or purpose whatsoever". The legal rate of interest had been reduced two years previously from 6 to 5 per cent, and Government was able to obtain the same reduction on its loans, and the savings were applied in aid of the sinking fund which was formed for the purpose of discharging debt by periodically setting aside sums to accumulate at interest.

In 1727 the rate of interest was reduced from 5 to 4 per cent and £400,000 was added to the sinking fund. In 1749 the rate on part of the debt was reduced to 3½ per cent for seven years and to 3 per cent thereafter. In 1750 the interest of the balance was reduced to 3½ per cent for five years and to 3 per cent thereafter. The operation of 1750 resulted in the saving of £600,000, which was utilised for sinking fund purposes. This system of a sinking fund was useless, as will be seen from the fact that between 1717 and 1788 most of the expenditure was absorbed, not in the repay-

¹ 3 Geo. I. c. 17. Cf. *An Inquiry concerning the Rise and Progress, the Redemption and Present State and the Management of the National Debt*, by Robert Hamilton (Edinburgh: Oliphant, Waugh & Innes, 1814); cf. Ricardo's "Essay on the Funding System" written for the Supplement to the sixth edition of the *Encyclopædia Britannica* and published in Ricardo's *Works* by McCulloch (London: John Murray, 1852).

² 8 & 9 Will. III. c. 20, and later Acts.

ment of debt, but in the payment of interest on debt and in ordinary expenditure. The total deficits in the annual Budgets were not far short of the whole sinking fund, and new debt almost equal in amount to the sinking fund was created. The following figures are of interest in this connection :

HISTORY OF THE ENGLISH SINKING FUNDS (1717-1788)		£ (millions).
Receipts	.	201
Expenditure :		
(1) Repayment of debt	24	}
(2) Payment of interest on debt	99	
(3) Ordinary expenditure	93	
	—	216
Excess of expenditure over receipts	.	15
Excess of expenditure over income (in annual Budgets)	.	185
Amount of loans raised	.	189
Excess of loans over deficits	.	4

Thus the sinking fund was diverted to purposes other than what was originally intended and its inviolable application to debt redemption given up. "On the whole", writes Hamilton in his trenchant criticisms on the sinking fund, "this fund did little in time of peace, and nothing in time of war, to the discharge of the National Debt. The purpose of its inviolable application was abandoned, and the hopes entertained of its powerful efficacy entirely disappointed."

Pitt's sinking fund of 1786¹ was established through the influence of Dr. Richard Price, whose scheme for a sinking fund was put forward in his *Treatise on Reversionary Annuities*, published in 1771. Price proposed the formation of a permanent Commission "acting under penalties in such a manner as would take it out of the hands of the Treasury and form a check upon the House of Commons itself".² The object underlying Pitt's fund was to set aside £1 million per annum or £250,000 quarterly out of the old surplus duties which formed the previous fund. This million sterling was to be used for the purchase of stock and the dividends thereon were to be accumulated at compound interest until the dividends on the purchased stocks

¹ 26 Geo. III. c. 31.

² Hamilton, *National Debt*, p. 130.

and the £1 million originally invested amount to £4,000,000. Thereafter the dividends on the £4 millions were not to be added to the sinking fund, but were to be utilised for the reduction of taxation or for any other purpose. In 1792 the principle of a true sinking fund was introduced by placing 1 per cent on all new loans issued for public purposes, *i.e.* an annual provision was made for gradual redemption in addition to interest. It was thought that by this system every loan would be automatically wiped out in 45 years at the latest. In 1798, 1799, and 1800 no provision of 1 per cent for a sinking fund was attached to the loans of these years. In 1802 the two sinking funds were combined, although the features of each were maintained. In 1807 Lord Henry Petty, Chancellor of the Exchequer, put forward a complex scheme which was adopted in the arrangement of the loan for that year, but, as Hamilton points out, since the Ministry which planned the scheme did not continue long in office, it was never followed after the first year. In 1813 Mr. Vansittart modified Pitt's sinking fund in such a way that it was restored to the state in which the proposals of 1786 and 1792 would have left it had no subsequent alteration taken place. Mr. Vansittart's main object was the final discharge of the old debt of 1786 and a continuous policy of applying a sinking fund to all loans subsequently raised in order to secure their redemption within the maximum period of 45 years. In 1817 the sinking fund of Ireland was consolidated with that of Great Britain, and in 1819 the whole question of these funds was considered by a Committee of the House of Commons. The result was that a resolution was passed to set aside £5,000,000 per annum from income for the purpose of discharging debt. Owing to a series of fictitious operations, one of which was borrowing from the sinking fund itself in order to show this surplus, the resolution was never actually carried out. In 1823¹ an effort was made to reconstitute the sinking fund by providing £5,000,000 a year from the consolidated fund, but this was misused in the next few years for the conversion of debt. In 1827 Lord Grenville published privately an essay, of which only the first part was printed—"An Essay on the Supposed Advantages of a Sinking Fund". The way had been prepared by the remarkable book of Hamilton published in 1813, and by Ricardo's "Essay on the Funding System", 1821; and these,

¹ 4 Geo. IV. c. 19.

especially the former, more than Grenville's essay, led to the recommendations of the House of Commons Finance Committee of 1828, which restored the idea of the sinking fund to its original and proper object. It was then decided that the sinking fund can only depend on (1) a surplus of revenue, and (2) the regular investment of this sum to be applied to the reduction of debt. It was suggested that the Chancellor of the Exchequer should aim at obtaining an annual surplus of £3,000,000 a year for this purpose. Goulburn, in his Budget speech of 11th July 1828, somewhat modified this proposal, and in 1829 a definite arrangement was arrived at by which one-fourth of the surplus of revenue in each year was to be issued to the National Debt Commissioners, who were empowered to buy Exchequer Bills or a portion of funded or unfunded debt whichever was advantageous. For about 40 years the principle of this arrangement was not interfered with, but the annual amount paid for the extinction of debt was far less than £3,000,000, being slightly over one-third of that amount.

In 1866 the special Acts that were on the Statute Book relating to sinking funds were repealed, but a provision was retained under which a surplus of income over expenditure was applied to the extinction of debt. This provision still survives under the name of the "Old Sinking Fund". In 1875 the "New Sinking Fund" of Sir Stafford Northcote was formed. It was an effective sinking fund, which has generally been carried on by his successors. A fixed amount was annually set aside for the service of debt. From this the balance after meeting interest charges was used as the new sinking fund.¹ The New Sinking Fund cannot be used for paying off Ways and Means advances. It will be seen that these funds are not sinking funds in the strictest sense of the term, since they are not definite sums annually set apart for the extinction of debt within a fixed period. An examination of the receipts of the British sinking funds from the end of the eighteenth century up to the first quarter of the nineteenth century (1828) shows that (1) half the actual receipts of the fund were raised by loans; (2) further debt was being incurred while the fund was accumulating; and (3) debt was incurred at a higher rate of interest to pay off debt at a lower rate,

¹ *Life, Letters, and Diaries of Sir Stafford Northcote, first Earl of Iddesleigh*, by Andrew Lang, 2 vols., 1890.

as loans raised at the beginning of the nineteenth century carried interest at £5 : 0 . 6, whereas previous loans carried only £4 : 10s. per cent. This difference of $\frac{1}{2}$ per cent on £330 millions was equivalent to £1 $\frac{1}{2}$ millions a year. In short, debt was incurred at a higher rate of interest to pay off debt at a lower rate, which is unsound finance, and this deserves the well-merited rebuke of McCulloch, who speaks of this British sinking fund as "this worthless compound of delusion and absurdity".

4. HAMILTON'S MAXIMS OF FINANCE

The absurdities of the sinking fund are not so clear to the reader of the financial history of the early part of the nineteenth century including the parliamentary debates as is sometimes imagined. Even during the War claims were put forward in some countries to pay off debt borrowed at a lower rate of interest from loans at a higher rate which contained some of the fallacies appertaining to the sinking fund. It was left to an Aberdeen Professor of Mathematics who wrote on public debt to show clearly the true principles to be followed in public finance.¹ Hamilton enunciated 12 maxims, which are as follows :

" (1) The annual income of a nation consists of the united produce of its agriculture, manufactures, and commerce. This income is the source from which the inhabitants derive the necessaries and comforts of life ; distributed, according to their stations, in various proportions ; and from which the public revenue necessary for internal administration, or for war, is raised.

" (2) The portion of national income which can be appropriated to public purposes, and the possible amount of taxation, is limited ; and we are already far advanced to the utmost limit.

" (3) The amount of the revenue raised in time of peace ought to be greater than the expense of a peace establishment, and the overplus applied to the discharge of debts contracted in former wars, or reserved as a resource for the expense of future wars.

" (4) In time of war taxes may be raised to a greater height than can be easily borne in peaceable times ; and the amount of the additional taxes, together with the surplus of the peace establishment, applied for defraying the expense of the War.

¹ Hamilton, *op. cit.*, especially Part III. p. 129, "Examination of Plans for the Redemption of the National Debt and other Financial Operations".

“(5) The expense of modern wars has been generally so great that the revenue raised within the year is insufficient to defray it. Hence the necessity of having recourse to the system of funding or anticipation. The sum required to complete the public expenditure is borrowed on such terms as it can be procured for ; and taxes are imposed for the payment of the interest ; or perhaps to a greater extent, with a view to the gradual extinction of the principal.

“(6) In every year of war where this system is adopted the amount of the public debt is increased ; and the total increase of debt during a war depends upon its duration and the annual excess of the expenditure above the revenue.

“(7) In every year of peace the excess of the revenue above the expenditure ought to be applied to the discharge of the national debt ; and the amount discharged during any period of peace depends upon the length of its continuance and the amount of the annual surplus.

“(8) If the periods of war compared with those of peace, and the annual excess of the war expenditure compared with the annual savings during the peace establishment, be so related that more debt is contracted in every war than is discharged in the succeeding peace, the consequence is a perpetual increase of debt ; and the ultimate consequence must be its amount to a magnitude which the nation is unable to bear.

“(9) The only effectual remedies to this danger are the extension of the relative length of the periods of peace ; frugality in peace establishment ; lessening the war expenses ; and increase of taxes, whether permanent or levied, during war.

“(10) If the three former of these remedies be impracticable, the last affords our only resource. By increasing the war taxes the sum required to be raised by loan is lessened. By increasing the taxes in time of peace the sum applicable to the discharge of debt is increased. These measures may be followed to such an extent that the savings in time of peace may be brought to an equality with the surplus expenditure in time of war, even on the supposition that the periods of their relative duration shall be the same for centuries to come that they have been for a century past.

“(11) When taxation is carried to the extent mentioned above, the affairs of the nation will go on, under the pressure of

existing burdens, but without a continual accumulation of debt, which would terminate in bankruptcy. So long as taxation is below that standard accumulation of debt advances; and it becomes more difficult to raise taxation to the proper height. If it should ever be carried beyond that standard, a gradual discharge of the existing burdens will be obtained; and these consequences will take place in the exact degree in which taxation falls short of, or exceeds the standard of average expenditure.

“(12) *The excess of revenue above expenditure is the only real sinking fund by which public debt can be discharged.* The increase of the revenue and the diminution of expense are the only means by which this sinking fund can be enlarged, and its operations rendered more effectual: and all schemes for discharging the national debt, by sinking funds operating by compound interest, or in any other manner, unless so far as they are founded upon this principle, are illusory.”¹

The last of these is the most important, but all the propositions are incontrovertible except that the first would be slightly modified to include services and the last clause of the third, viz. on hoards, is not now adopted by financiers. Hamilton was the first to point out in the clearest possible way the fallacy underlying Pitt's sinking fund. Undoubtedly Price's idea that the old sinking fund was accumulating at compound interest and paying off debt by its own unaided force was to some extent correct. If the fund has been invested abroad and the interest received also invested abroad, a large annual sum would have been in reality bearing compound interest and paying off national debt. In the words of Hamilton: “When Dr. Price says that a debt of £258 millions might be discharged in 86 years, at no greater expense than an annual saving of £200,000, he overlooks the taxes imposed year after year, for the payment of interest; a great part of which would not have been needed, if that annual sum had not been separated from the public revenue. . . . The Doctor's plan for discharging the national debt by borrowing money at simple interest, in order to improve it at compound interest, is, we apprehend, completely delusive. He admits the absurdity of such a measure in private life, and its absurdity in national finance is exactly the same.”²

¹ Hamilton, *National Debt*, pp. 7-11.

² Hamilton, *National Debt*, pp. 139 and 141.

5. WAR-TIME FINANCE

The distribution of the debt in the pre-War and at the present time is seen in the following table :

BRITISH NATIONAL DEBT (in £ Millions)

	Before the War, 31/3/1914.	At the End of the War, 31/3/1919.	Present Time, 31/3/1924.
Funded Debt	587	318	314
Terminable Annuities	30	21	14
3½ per cent Conversion Loan . . . . .	..	..	684
3½ per cent War Stock . . . . .	..	63	63
4½ per cent War Stock . . . . .	..	14	13
4 and 5 per cent War Stock . . . . .	..	2068	2095
National War Bonds . . . . .	..	1636	903
4 per cent Funding Loan . . . . .	..	..	399
4 per cent Victory Bonds . . . . .	..	..	325
Treasury Bonds . . . . .	..	..	444
Exchequer Bonds	20	381	150
Savings Certificates . . . . .	..	227	366
Other debt (including American debt)	..	1241	1151
American Loan (Anglo-French) . . . . .	..	51	..
Treasury Bills	13	957	588
Temporary advances . . . . .	..	455	186
Total	650	7435	7695
Other capital liabilities	56	46	71

The War was financed by means of 25 votes of credit spread over the following years :

Year.	Votes.	Amount (£ Millions).
1914-15	3	362
1915-16	6	1420
1916-17	7	2010
1917-18	6	3050
1918 (April to November)	3	1900
	25	8742

The average daily expenditure during the War was £1½ millions in 1914-15, £3½ millions in 1915-16, £6½ millions in 1916-17, and

£7 millions in 1917-18. The percentage of loans to revenue for the year ended 31st March 1915 and the subsequent four years was as follows :

Year ended 31st March.	Percentage of Receipts from	
	Loans.	Revenue.
1915	64	36
1916	78	22
1917	74	26
1918	74	26
1919	65	35
1920	19	81

The aggregate figures for the British financing of the War from 1st August 1914 to 16th November 1918, five days after the Armistice, were approximately £8662 millions, of which loans were £6442 and the yield of revenue £2220. Receipts from revenue were, therefore, 25 per cent of the total on an average. It is interesting to compare this with the total Australian war expenditure for the seven years ending 30th June 1922, which was £477 millions, of which £135 millions was charged against revenue (28 per cent) and £342 millions (72 per cent) against loans.

In the tables above external debt is included with the internal debt in the total figures. The debt consists of loans mainly from the United States and Canada, the amount from the United States being \$4604 millions or £920 millions, of which slightly over \$4 millions was repaid on 15th March 1923 in cash, and the interest on the balance is 3 per cent for 10 years and 3½ per cent thereafter until redeemed by the operation of the accumulative sinking fund of ½ per cent in 62 years. Interest is payable on 15th June and 15th December. Principal is payable on the 15th December annually from 1923 to 1984.¹ The debt to Canada is £53 millions. The total external debt amounted on 31st March 1922 to £1089 millions. There are, on the other hand, external loans or assets amounting to a total of £2141 millions, made up as follows : £150 millions the Dominions (Australia £91 millions, New Zealand £30 millions, Canada £14 millions, South Africa

¹ Table XXX., App

£12 millions, and other colonies £3 millions), Allies £1877⁷ millions (Russia £655 millions, France £602 millions, Italy £528 millions, Yugo-Slavia £26 millions, Rumania £24 millions, Greece £22 millions, and Portugal £20 millions). For relief £19 millions have been granted (including Austria £10 millions, Poland £4 millions, Rumania £2 millions, Yugo-Slavia £2 millions, Czecho-Slovakia £ $\frac{1}{2}$ million, and others £ $\frac{1}{2}$ million), and for reconstruction in Belgium £9 millions and Austria £2 $\frac{1}{2}$ millions. There are miscellaneous assets such as Suez Canal shares (£19 millions), and investments in various registered companies such as the Anglo-Persian Oil Company (£5·2 millions), the Cunard Steamship Company (£2·6 millions), the British Dyestuffs Corporation (£1·7 millions), the British Cellulose and Chemical Mfg. Co. (£1·5 millions), the Commercial Bank of Siberia (£1·2 millions), the Standard Shipbuilding Co. and other concerns (£1·8 millions).

There are one or two features regarding the loans raised during the War which require special notice. In the first place, for the first time in history Great Britain was compelled to borrow large sums abroad. The first foreign loan was issued in New York in 1915. The loan was a 5 per cent five-year loan for \$500 millions. The loan was repaid on maturity on 15th October 1920 and strengthened American confidence in British credit. Subsequently the British Government issued its own loans in New York, collateral security being provided in the form of dollar bonds which the British Government paid or borrowed from its own nationals under the Dollar Security Mobilisation Scheme. Credits were also raised through agents of the British Treasury in New York in 1917. After the entry of the United States into the War the British Government borrowed funds freely from the United States Government direct. Loans were also raised in Argentina, Uruguay, Chile, Spain, Switzerland, Holland, and Sweden, but these were rapidly repaid, the outstanding debt being the debt to America, which remained unpaid till June 1921. Another characteristic of this period is that consols gave way to the 5 per cent War Loan issued at the beginning of 1917. The cash subscriptions to the 5 per cent War Loan of 1917 amounted to £966 millions, and conversions of the earlier 4 $\frac{1}{2}$ per cent loan and Exchequer Bonds amounted to £1104 millions, making a total of £2070 millions. A third characteristic was the principle adopted in 1915 of "continuous borrowing", when 5 per cent

BRITISH WAR LOANS

Issue.	Date of Issue.	Price of Issue.	Cash Receipts only, i.e. paid into Bank of England on Government Account. (£ millions).
1. 3½% Loan 1925-1928 . . .	1914, Nov. 17-24	95%	332
2. 3% Exchequer Bonds 1920 . .	1915, March 5-10	£95 18 1 (tender average)	48
3. 4½% War Loan 1925-45 . .	1915, June 21-July 10	Par	592
4. 5% Exchequer Bonds 1920 . .	1915-16, December 17 June 1	Par	238
5. 5% Exchequer Bonds 1919 . .	1916, June 2-Sept. 27	Par	34
6. 5% Exchequer Bonds 1921 . .	„ June 2-Oct. 2	Par	62
7. 6% Exchequer Bonds 1920 . .	„ Oct. 2-Dec. 30	Par	161
8. 5% War Loan 1929-47 . .	1917, Jan. 11-Feb. 16	95%	} 941
9. 4% War Loan 1920-42 . .	„ Jan. 11-Feb. 16	Par	
10. 5% Exchequer Bonds 1922 . .	„ Apr. 13-Sept. 22	Par	82
<i>National War Bonds:</i>			
11. 1st series . . .	1918, Oct. 1, 1917-March 31	Par	616
12. 2nd series . . .	1918, Apr. 1-Sept. 30	5% War Bonds Par 4% April-1-22 Par Apr. 23-Sept. 30, 101½%	} 483
13. 3rd series . . .	1919, Oct. 1, 1918-Jan. 18	5% Bonds Par 4% Bonds 101½%	
14. 4th series . . .	1919, Feb. 1-May 31	5% Bonds Par 4% Bonds 101%	} 76
15. 4% Funding Loan . . .	„ June 12-July 12	80%	
16. 4% Victory Bonds . . .	„ June 12-July 12	85%	217

NOTE.—The amount of issue in each case was unlimited except in the case of Nos. 1 and 2, which were limited to £350 and £50 millions respectively.

Exchequer Bonds were placed on sale. The fourth of this series of Exchequer Bonds, the 6 per cents, were closed at the end of December 1916 in order not to stand in the way of the 5 per cent War Loan, the biggest loan floated during the War in Great Britain. In the sale of War Bonds continuous borrowing was justified. Prices were, to a large degree, kept within limits by the withdrawal from circulation of a large amount of currency at the time when inflation was almost unavoidable. A fourth characteristic was that there was the system of tax compounding in the 4 per cent loan which was introduced along with the 5 per cent loan of 1917 in order to meet the investor who demanded exemption from income tax. In the 5 per cent War Loan, the National War Bonds, and the Funding Loan a departure from the collection of income tax at source occurred, the investor being paid the whole dividend without any deduction. Interest on the 4 per cent loan was reduced to a figure which allowed for the compounding of income tax at the maximum rate prevailing. The interest on the loan was not exempt from super tax, and for calculation purposes it was assumed that the 4 per cent interest was the net income after the deduction of income tax at the full normal rate of income tax then prevailing—5 shillings in the £.

In some of the loans issued by the Treasury a right of conversion into any future War Loans was given, as, for example, in the issue of the $4\frac{1}{2}$ per cent loan of 1915 and the subsequent Exchequer Bonds. The Treasury also set aside a sum equal to 1s. 8d. per cent of each loan to purchase stock whenever the market price fell below the issue price. It is said that about £30 millions was annually spent on this, but it did not prevent the stocks falling to a heavy discount. It was also arranged that bonds could be bought and sold with greater ease than hitherto. In March 1918 an issue of £5 bonds was made and could be bought just like postage stamps. The success of War Savings Certificates, issued at 15s. 6d., capable of being paid for in instalments and repayable in five years from the date of purchase at £1, proved to be very successful.

CHAPTER XXXVI

THE HISTORY OF PUBLIC DEBT IN OTHER COUNTRIES

I. INDIA

THE debt of British India we have seen was Rs.877 crores (£585 millions) on 31st March 1924, comprising Rs.578 crores (£385 millions) productive and Rs.299 crores (£200 millions) of dead-weight debt. The Government accounts class as debt incurred for productive purposes the outlay on railways, irrigation works, telegraphs, and telephones. These yield normally a net profit to Government. Even in 1922-23, when the railway accounts showed a small net loss of less than half a crore of rupees in the working of railways, the apparent loss is converted into a gain of about a crore if account is taken of certain expenditure charged to the revenue accounts of railways. The annuity payments from railway receipts consist of two parts, interest on the outstanding capital and the payment in extinction of that outstanding. The latter is in the nature of a redemption of capital, and although it is charged to revenue in the Government accounts it is legitimate not to regard it as a revenue charge in determining the yield to the State from railway undertakings. The unproductive debt is less than $2\frac{1}{2}$ times the total revenue of the Central Government at the present time. Prior to the War almost the entire debt of the Government of India was of a productive character, and the subsequent unproductive debt is traceable (1) to the War contribution of £100 millions (had it not been for this the ordinary debt would have been almost completely wiped out in 1917); (2) the outlay on the building of the new capital at Delhi (Rs.8 crores); and (3) the revenue deficits which since 1919 have been financed from borrowings. Against this unproductive debt the Government of India hold assets of cash balances in India and in England

(Rs.35 crores), the gold standard reserve (Rs.60 crores), loans made to native States, and local bodies, etc. (Rs.20 crores), leaving an uncovered debt of Rs.184 crores, or a little more than the total annual revenue of the Central Government. In addition there are other far larger assets, such as real and other property, belonging to Government. Since the Reformed Constitution of 1919 provincial Governments have been granted considerable powers of borrowing. Only two Governments have so far placed loans on the market, while the rest have been able to obtain their funds by loans from the Central Government. One of these public loans was floated by the Government of Bombay in 1921 for the development of Bombay. The other loans have been devoted to productive schemes like irrigation works, forest development, advances to local bodies, or other minor schemes of general utility ; a sinking fund for the amortisation is established in the last case when the schemes are unproductive. A few provincial Governments in the last few years have also borrowed for financing revenue deficits, but the amounts have not been substantial enough to affect the general position as stated above.

From 1921 to 1922, it will be remembered, the Budget marked a new era, as it was the first Budget under the new constitution, the Central Government's Budget being separate from those of the provinces. Since 1921-22 there has been a considerable reduction in the floating debt, and the position now is as follows :

	1921-22.	1922-23.	1923-24.
Funded or permanent debt	Rs. lakhs. 523,87	Rs. lakhs. 703,79	Rs. lakhs. 752,01
Temporary or unfunded debt, including Treasury Bills	198,78	133,80	125,13
	722,65	837,59	877,14

The Finance Member in his Budget speech of 1924-25 said : " We have got rid of practically all our embarrassments in regard to floating debt and can face the necessity of meeting short-term bonds which mature in the next few years with confidence. There is no longer any fear of our being forced to undesirable expedients, such as currency inflation, in order to meet our outgoings. And if the time has not yet come at which we can replace the present

statutory, but inoperative, ratio of 2s. gold to the rupee by an effective ratio, this is due not to our inability to maintain our currency in a sound condition but to a continuance of economic instability in other parts of the world, which makes immediate stabilisation unattractive." The improvement in the country's finances reflects itself in the market quotations of the Government securities. The 5 per cent tax-free loan (1945-55) was quoted at Rs.88-10 on 15th February 1923. On the corresponding date in 1924 it had risen to Rs.98. It was proposed to assign in 1924-25 Rs.4 crores annually for the first five years for debt redemption. This amount is made up chiefly of obligatory payments, *e.g.* contractual railway annuities about Rs.3 crores and contractual depreciation fund against 5 per cent loans about Rs.0.7 crore. Indian gilt-edged securities have improved more than those of Dominion and foreign securities from the low level to which post-War events reduced them. The position at the present time is shown in the following table :

DEBT OF THE GOVERNMENT OF INDIA ON 31ST MARCH 1924	
In India—	Rs. Lakhs.
Loans (Permanent Debt)	358,89
Treasury Bills in the hands of the public	2,13
Treasury Bills in the Paper Currency Reserve	49,65
Post Office Savings Banks	24,87
Cash Certificates	8,51
Provident Funds, etc.	39,97
Total, India	484,02
In England (at Rs.15 to the £)	393,12
Total	877,14
Productive	578,39
Unproductive debt	298,75
Permanent debt	752,01
Temporary or floating debt	125,13

The debt per head was Rs.35.4 in 1923-24. The percentage of debt charges to expenditure was 15¹ in 1921-22, as compared with the following figures for Great Britain, the Dominions, the United States, France, and Japan.

¹ Central and Provincial.

PERCENTAGE EXPENDITURE ON DEBT SERVICES, TO TOTAL
ORDINARY EXPENDITURE *

Country.	Year.	Percentage.
France	1924	53·8
U.S.A. †	1921-22	44·2
Great Britain	1923-24	39·0
New Zealand	1922-23	33·8
Canada ‡	1921-22	33·5
South Africa	1920-21	28·6
Australia §	1922-23	23·8
Japan	1921-22	18·4

* See Table XXIX., App.
‡ Dominion and Provinces.

† Federal.
§ Commonwealth and States

The Government of India have made conversions from time to time. Conversions took place in 1871, 1880, 1887, 1894, 1896, 1908, 1916, and 1917. Six per cent as a maximum rate ended in 1858-59, and did not appear again until 1920-21. In the troubles of 1857-59 facilities to holders of scrip were given to convert their holdings into notes bearing higher rates of interest. The Government of India, in the stress and strain of 1857, stated that "the 5 per cent loan, which would have been adequate for ordinary wants and in ordinary times, was found to be inadequate at that time of extreme pressure. Accordingly it was necessary to induce capitalists to come to the assistance of the State by an enhancement of the terms, and the Governor-General in Council resolved to borrow at 6 per cent. He was aware that this could not be done without in some degree affecting injuriously those holders of the paper of former loans, who had not purchased for purposes of permanent investment; but this is the condition of all such holders of Government stock in all countries whenever a great exigency forces upon the State the necessity of raising a large sum in a limited time. The Governor-General in Council, however, was desirous to save such holders from loss, as far as that could be done consistently with the paramount object in view. Therefore, instead of simply opening a 6 per cent loan, which would have brought down the price of 4 and 5 per cent paper to a low point, he threw open the then existing 5 per cent loan to subscriptions, half in cash and half in 4 per cent paper. This arrangement for many months answered the purpose; the market price of the paper of former loans was but little affected by the operation,

and the expectations of Government were fully met by large and regular subscriptions through the medium of the then existing holders of 4 per cent stock, or those who purchased of them for the express purpose of subscribing to the loan." Eight crores were paid in cash. In 1859 the Government of India similarly announced a $5\frac{1}{2}$ per cent loan to the extent of 5 crores of rupees, to which subscriptions were received in cash, or half in cash and half in 5 per cent paper. It was also stated at the same time that no loan carrying a higher rate of interest would be opened in India during the year unless under instructions from the Home Government.¹ The rates were reduced to $3\frac{1}{2}$ per cent in 1894 and to 3 per cent in 1896. From 1859-60 to 1878-79, $5\frac{1}{2}$ per cent was the maximum rate, and the rate of $5\frac{1}{2}$ per cent did not reappear until 1916-17. Five per cent loans existed from 1823-24 to 1871-72, and are not found again until 1916-17. Four and a half per cent loans date from 1856-57. Certain 4 per cent loans were issued in 1824-25, and this rate is still paid on part of the National Debt. Three and a half per cents date from 1853-54 and 3 per cents from 1896-97. Loans are of two classes, non-terminable and terminable loans. The non-terminable rupee loans are those which Government have undertaken not to repay before a certain date, and are repayable at the option of Government (with notice) after that date. These loans are now repayable at the option of Government after three months' notice, as the dates before which repayment was not to be made have expired. The terminable loans are repayable on a fixed date, or not before a certain date and not later than another fixed date.

In 1921, in the Council of State, a resolution was passed to the effect that "The financial policy of Government be so directed as to ensure the early rehabilitation of Government securities, with due regard to the necessity of funding the temporary debt and to the provision of capital expenditure for productive purposes". Two committees were appointed, one in Calcutta and one in Bombay. Both committees were opposed to any concessions, such as the raising of the rate of interest, which would benefit the holders of low interest-bearing securities at the

¹ Notifications relating to the public loans of the Government of India published in the Government of India *Gazette* from 1822 to 1889 (Calcutta, Superintendent, Government Printing, India). Cf. also Report of the Bombay committee to inquire into the rehabilitation of Government securities (Calcutta, Superintendent, Government Printing, India, 1919).

expense of the general taxpayer. The Calcutta Committee, however, made the surprising suggestion that "we consider that all future Government loans should be exempt from income tax, but in the case of existing securities which are liable to the tax, we recommend that the rate at which income tax is deducted at the source should be standardised at one anna in the rupee".¹ Owing to financial pressure in the War, India, like Great Britain, issued income tax free securities, but this will not in all probability be done in future, since it is unfair to the State.² The Bombay Report, which is an interesting document, suggests that Government should publicly announce that it would pay off the 3 and 3½ per cent loans between forty-five and fifty years from 1921, and that it should undertake to purchase by public tender and to cancel each year 2 per cent of the amount of such securities outstanding at the beginning of the year, such purchase to be effected during the course of the year. It may be doubted whether Government should borrow at a higher rate of interest with one hand to purchase securities the interest of which is at a lower rate. There may be reasons of a politico-financial nature to encourage investors, but these proposals have usually to be regarded from the viewpoint of sound finance. The Government of India, in publishing in 1921 the Reports on the rehabilitation of securities, wisely did not commit themselves to the precise action they proposed to take, since future liabilities in the matter of new capital expenditure were not sufficiently clear to enable them to decide upon the borrowing policy of the future.

The Report of the Bombay Committee, of which Sir Dadiba Dalal (now High Commissioner for India) was chairman, stated that "India is full of money, and self-contained to supply all funds necessary for the expansion of its railways and irrigation systems, and for the development of industries. . . . We are of opinion that year after year India will be able to spare increasing sums of money for the building of railways, canals, and industries, and for provincial development. Unfortunately the money power of India is not properly mobilised. Money lies dormant in endless small hoards all over the country. There is a vast virgin

¹ Report of the Calcutta Committee dated 30th April 1921, paragraph 6.

² The rupee loan of 1924-25, however, was for special reasons free of income tax (5 per cent bonds of 1933 issued at 98½ and the main loan issued at 99, with interest at 5 per cent and repayable neither before 1945 nor later than 1955).

field for the development and expansion of banking and for the collection into bank reserves of the innumerable stores of money lying idle throughout the country, which could be utilised for the benefit of the holders and for the good of trade and of the State.”¹ It is extraordinary how ignorant people are in India of the facilities of investing in securities, especially through the Post Office. They do not know how to make an investment in a loan, to draw interest, to make endorsements on Promissory Notes, to renew securities, etc. This recalls a minute by the Rt. Hon. James Wilson in 1859 before introducing currency notes in India. He made elaborate preparations for the translation in various provinces of what the currency system meant, and the method of publicity even at that period was remarkable. There can be no doubt that the War taught people, especially in Great Britain and the United States, how to save. “I doubt”, said President Wilson, “that many good by-products can come out of a war, but if our people learn from this war to save, then the War is worth all it has cost us in money and material.” Compared with 1914, in Great Britain and America there was a limited circle of large investors. Publicity began and ended with the issue of a prospectus in the press, and its distribution by a limited number of bankers and stockbrokers. There was an undoubted reluctance on the part of officials to depart from traditional procedure, and a prejudice against any lapse from official dignity. To-day in the West there is a new state of things made possible by the savings movement. The War Loan publicity campaigns in the United Kingdom, and the Liberty Loan publicity campaigns in the United States, show what can be done. “Business men’s weeks”, “feed the guns weeks”, “war weapons weeks”, the issue of postmarks on letters, the issue of letters to different people, all had an extraordinary effect in Great Britain. Liverpool, for instance, was asked to purchase a battleship by investing sufficient to purchase this, but she invested sufficient to purchase no less than six. There is undoubtedly room for the recommendation made by Sir Dadiba Dalal’s committee suitable to present conditions. The Bombay Committee also suggested: “In order to create broad and expanding markets for securities and to rehabilitate the existing securities, Government should endeavour to establish Stock Exchanges in each of the provincial

¹ Paragraphs 28 and 29 of the Report.

capitals, under non-official control, and should give a grant for land and buildings at places where Stock Exchanges do not exist at present".¹ Recently the Report of the Bombay Stock Exchange Enquiry Committee has made further recommendations, which should be a step in the direction of better Stock Exchanges.² In India much remains to be done to popularise the investing habit. People prefer to put their money into gold jewellery rather than securities. An Indian wedding is still, even for the poorer classes, an expensive and even wasteful affair. The parents, too, instead of giving the bride and bridegroom securities, prefer the less economical way of giving jewellery. Intensive and persistent propaganda is necessary, as social customs die hard with us. Still, the investing habit is growing. Post Office Cash Certificates were started in India in 1917, and before

PUBLIC DEBT OF INDIA *

Year ending 31st March.	Debt.	Debt Charges.	Increase of Debt over Previous Year in the Table.	
			Net Amount.	Per Cent.
	Lakhs of Rs.	Lakhs of Rs.		
1845	43,50	..	..	..
1857 Year of the Mutiny .	59,46	..	15,96	36.7
1862	107,51	6,62	48,05	80.8
1872 About fifty years ago	115,87	7,69	8,36	7.7
1882 „ forty „ .	166,92	6,75	51,05	44.1
1892 „ thirty „ .	222,26	10,10	55,34	33.2
1902 „ twenty „ .	339,35	11,16	117,09	52.7
1912 „ ten „ .	454,72	14,83	115,37	34.0
1914 Pre-War year . .	461,09	15,19	6,37	1.4
1915	478,41	15,77	17,32	3.8
1916	479,11	15,99	70	0.2
1917	476,60	15,52	- 2,51	- 0.5
1918 India took over £100 million War contribution	667,70	25,50	191,10	40.1
1919	683,37	26,95	15,67	2.3
1920	698,60	28,90	15,23	2.2
1921	664.70	28,28	- 33,90	- 5.1
1922	722,65	35,97	57,95	8.7
1923 †	837,59	36,24	114,94	15.9
1924 ‡	877,14	38,64	39,55	4.7

* See Table XXVI., App.

† Central Government only.

‡ Central Government only. Revised Estimates.

¹ Paragraph 31 of the Report.² Report of the Bombay Stock Exchange Enquiry Committee (Bombay Government Central Press, 1924).

31st March 1919 brought in a net sum of Rs.8 crores, owing to a strenuous campaign for saving. From then withdrawals exceeded deposits, but in 1923-24 fresh efforts have popularised this form of investment. During the ten months ended 31st January 1924, deposits amounted to Rs.6 crores gross or Rs.4½ crores net.

The history of the Indian debt in tabular form is given on the preceding page.

The Indian debt is made up as follows :

DEBT OF THE GOVERNMENT OF INDIA

<i>In England</i> (at Rs.15 to the £) —				Lakhs of Rs.
Loans . . . . .	.	.	.	364,22
War contributions . . . . .	.	.	.	28,90
Total in England . . . . .	.	.	.	393,12
<i>In India</i> —				
Permanent debt—				
6 per cent War Bonds . . . . .	.	.	.	125,36
5½ per cent War Bonds . . . . .	.	.	.	29,35
5 per cent debt . . . . .	.	.	.	65,13
4 per cent debt . . . . .	.	.	.	12,09
3½ per cent debt . . . . .	.	.	.	119,35
3 per cent debt . . . . .	.	.	.	6,30
Others . . . . .	.	.	.	1,31
Total permanent debt . . . . .	.	.	.	358,89
Temporary debt—				
Treasury Bills issued to the public . . . . .	.	.	.	2,13
Treasury Bills issued to the Paper	.	.	.	
Currency Reserve . . . . .	.	.	.	49,65
Post Office Savings Banks . . . . .	.	.	.	24,87
Cash Certificates . . . . .	.	.	.	8,51
Provident funds, etc. . . . .	.	.	.	39,97
				125,13
Total debt . . . . .	.	.	.	877,14

Floating debts are in various forms. “Ways and Means advances” are given by the Imperial Bank of India. Treasury Bills are open to the public and are current from three to twelve months. They are issued at discount, and the difference represents the return for the investment. The lowest denomination is of Rs.5000. The issue of these dates from 1917. Post Office Cash Certificates are mainly intended for small investors. Exchequer or Government Bonds are issued for three, five, or ten years, and originated during the War. Debentures are

current for a specified short period and are repayable after that date. Debenture Stocks carry no promise of repayment within a fixed time. They are redeemable on some distant date in the future at the option of Government. Debentures and Debenture Stocks are issued by the Secretary of State on behalf of certain railways. Government securities are in the form of Stocks, Bearer Bonds, and Promissory Notes. Stock-holders are entered in the books of the Public Debt Office and are granted a certificate to that effect. The ownership of Stock depends on the registry of the name in the Government books and not on the possession of the certificate. Thus immunity against loss of the certificate is secured. The interest on these securities is payable at any treasury required by the holder. Bearer Bonds are easily negotiable, and the possessor who may not be the owner has every right to them. Interest is paid on the presentation of coupons attached to them. Promissory Notes are a compromise between the perfect security of Stocks and the ready negotiability of Bearer Bonds. They are transferable by endorsement.

The issue of rupee loans¹ in India does not require Parliamentary sanction, but the issue of sterling loans in England requires the sanction of Parliament. The necessity for sanction arises from the fact that the East India Company, the predecessor of the Government of India, was required by statute to obtain sanction for floating loans. This Parliamentary sanction places the Indian sterling loans under the trustee securities, and this is an advantage to the investor. This sanction does not, of course, mean any guarantee by Parliament for the payment of the principal or the interest of these loans. The present tendency of the Government of India is to borrow more and more in India. In recent years India has had to depend on her own resources to an increasing extent. In the present century, prior to the War, the maximum amount raised in rupee loans by Government was Rs.5 crores² in 1914. The figures of recent years are as follows :

¹ The Indian legislature does not determine the amount or terms of the loans issued by the Government of India.

² It cannot be too often stated that a crore of Rs. = £666,667, or approximately two-thirds of a million sterling. The money was raised in July 1914, and is therefore before the War.

RUPEE LOANS OF THE GOVERNMENT OF INDIA

Year.	Amount advertised.	Amount subscribed.		
		By Conversions of War Bonds and Treasury Bills.	In Cash.	
			Nominal Value.	At Rate of Issue.
		Rs. Crores.		
1913-14	3.0	..	3.0	2.9
1914-15	5.0	..	5.0	4.8
1915-16	4.5 *	..	5.0	5.0
1916-17	6.0 †	..	6.7	6.7
1917-18	unlimited	.. ‡	44.3	44.3 §
1918-19	„	4.3	52.8	52.8 §
1919-20	„	2.9	18.4	17.4 §
1920-21	„	18.1	11.7	11.7 §
1921-22	„	12.1	37.1	37.1 §
1922-23	„	4.5	42.4	42.4 §
1923-24	24.0	0.1	23.9	23.1
1924	15	..	..	..

* Plus anything contributed through the Post Offices.

† Applications in excess of this amount up to a maximum of Rs.12 crores were to be accepted if received.

‡ In 1916-17 and 1917-18 certain conversions from old rupee paper to current loans were permitted. The sum thus converted in these two years was about Rs.23.8 crores.

§ Excluded from these figures are the amounts received in cash through Cash Certificates in the years 1917-18 to 1922-23, which were as follows :—Rs.10.0, 3.2, 0.9, 0.5, 0.5, and 0.7 crores.

NOTE.—It will be seen from the table above that the gross subscriptions have increased, especially since the loan of 1917. The gross subscriptions, including Cash Certificates, were as follows :—1913-14, Rs.3 crores ; 1914-15, Rs.5 crores ; 1915-16, Rs.5 crores ; 1916-17, Rs.6.7 crores ; 1917-18, Rs.54.3 crores ; 1918-19, Rs.60.3 crores ; 1919-20, Rs.22.2 crores ; 1920-21, Rs.30.3 crores ; 1921-22, Rs.49.7 crores ; 1922-23, Rs.47.6 crores ; and 1923-24, Rs.24 crores.

Since the middle of last century to the present time India has followed a cautious and profitable policy of what may be termed Victorian or Gladstonian finance. One of the proudest features in her public finance is the manner in which the country has been able for this specialised work to command the services of the most capable financial intellects, those of His Majesty's Treasury in Whitehall not excepted.¹ The list contains many names, such as those of the Rt. Hon. James Wilson, Lord Cromer, Sir James Westland, and Sir Clinton Dawkins. Perhaps this may be to some degree due to the wonderful and absolutely irresistible fascination of India. These no light services are widely acknowledged by Indians conscious of the great work performed.

¹ The present Finance Minister, for example, was Controller of Finance, H.M. Treasury.

2. UNITED STATES OF AMERICA

The history of the United States public debt is, especially in the twentieth century, full of interest. In 1789 Alexander Hamilton was selected by Washington to take charge of and organise the Treasury. He carried through as Secretary a scheme of funding which proved beneficial. Adams, however, says, "It is a serious criticism upon the financier who funds a series of floating obligations or who converts a funded debt that any reasonable policy of debt payment should thereafter be embarrassed by the terms of the contract in the newly created obligations. The conversion of a debt should be regarded as an opportunity for bringing the debt under control so far as ultimate payment is concerned. The funding scheme of Alexander Hamilton and the refunding programme of Secretary Sherman are alike open to criticism from this point of view."¹ The work of Alexander Hamilton, nevertheless, is of outstanding merit in this period in regard to public debt.² The growth of the debt is seen in the following table :

NATIONAL DEBT OF THE UNITED STATES *

	Debt (\$ millions).		Debt (\$ millions).
1790	75	1885	1578
1796	84	1890	1122
1812 (War, 1812-14).	45	1895	1097
1816	127	1900	1263
1819	96	1905	1132
1825	84	1910	1147
1832	24	1913	1193
1833-35	Debt extinguished	1914	1188
1846 (War, 1846-47).	16	1915	1191
1852	63	1916	1225
1857	28	1917 (War, 6th April)	2977
1860	65	1918 (Armistice, 11th Nov.)	12,244
1861	91	1919	25,482
1862	514	1920	24,298
1863 } Civil War	1120	1921	23,976
1864	1816	1922	22,964
1865	2846	1923	22,350 †
1875	2156		

* Exclusive of gold, silver, and currency certificates and treasury notes of 1890 (Statistical Abstract of the United States, 1922).

† This gross debt is made up of interest bearing (between 2 and 6 per cent) \$22,008 millions, and non-interest bearing \$342 millions.

¹ Adams, *Finance*, p. 555 ; cf. his *Public Debts*, p. 226.

² *Public Credit*, 9th January 1790 ; *Public Credit*, 16th January 1795. These two important reports rank with three others equally well known : *National*

The debt leapt up during the war of 1812-1814, when no less than 92 per cent of the war expenditure (\$64,300,000 out of \$70,000,000) was met from loans, a percentage even less satisfactory than that of France in the recent Great War. By 1833 the debt was so reduced that it was practically redeemed in the triennium 1833-1835. The increase in the Civil War, 1861-1865, is clearly seen from the table above. The lessons learned from the issue of inconvertible paper have not been forgotten. In 1865 the debt had reached a level that was not touched until the United States entered the War in 1917. The maximum was reached in August 1865, \$2846 millions, as against \$2977 millions in 1917. Of \$2846 millions the greater portion was in the form of floating debt (\$1276 millions) and inconvertible paper (\$460 millions). The funded debt amounted to only \$1110 millions. A sinking fund law was passed in 1862, but it did not become operative until 1866, as there was no real surplus. In 1868 the temporary debt was paid, and henceforth repayment and conversion were possible. The rates of interest fell towards the end of the century. In 1890 the debt was \$1122 millions, and in 1895 the debt was \$1097 millions. In the first year of the present century it was \$1263 millions, in 1910 \$1147 millions, and in 1916, the year previous to America's entry into the War, \$1125 millions. The great increases from 1918 to 1920, and the fall to 1923, are brought out in the statement above. An analysis of the public debt on 30th June 1923 shows the high credit of the country, and the phenomenal successes in regard to the four Liberty Loans and in the Victory Liberty Loan of 1922-23. The total debt is very much less than that of France and also of Great Britain, although the United States is the wealthiest of the three Powers.¹

Bank, 13th December 1790; *Establishment of a Mint*, 28th January 1791; and *Encouragement and Protection of Manufactures*, 5th December 1791. (*Vide* Lodge's edition, New York, 1885, vol. ii., "Finance and Taxation"; vol. iii., "Finance, Taxation, and Commercial Relations". Cf. *American State Papers*, vol. i.) "It will be the truest policy of the United States to give all possible energy to public credit," said Hamilton, "by a firm adherence to its strictest maxims, and yet, to avoid the ills of an excessive employment of it, by true economy and system in the public expenditure, by steadily cultivating peace, and by using sincere, efficient, and persevering endeavours to diminish present debts, prevent the accumulation of new, and secure the discharge within a reasonable period, of such as it may be at any time a matter of necessity to contract."

¹ For the wealth of these three countries see Table XXXII.

PUBLIC DEBT OF THE UNITED STATES ON 30TH JUNE 1923

	\$ Millions.
1st Liberty Loan, 30 years (1932-47), $3\frac{1}{2}$ per cent	1,952
2nd „ „ 1927-42, 4 per cent	3,199
3rd „ „ 10 years (1928), $4\frac{1}{2}$ per cent	3,408
4th „ „ 20 years (1933-38), $4\frac{1}{2}$ per cent	6,329
Notes (Victory Liberty Loan, 1922-23, Treasury notes, etc.)	4,104
Certificates of indebtedness	1,031
Treasury War Savings Certificates	337
$4\frac{1}{2}$ per cent Treasury Bonds (1947-52)	764
2 „ Bonds (1930)	600
4 „ „ (1925)	118
2 „ Canal (1916-36)	49
2 „ „ (1918-38)	26
3 „ „ (1961)	50
3 „ Conversion (1946-47)	29
$2\frac{1}{2}$ „ Postal (1st to 24th)	12
Interest bearing	22,008
Non-interest bearing	342
<hr/>	
Total	22,350
Matured interest	176
<hr/>	
	22,526
Less cash in Treasury	370
<hr/>	
Net debt of U.S.A.	22,156
<hr/>	

European countries, mainly Great Britain, France, and Italy, are the debtors to the United States to the extent shown in the table on following page.

The British debt, as explained above,¹ is now funded, the Debt Funding Commission having fixed the total sum repayable at \$4600 millions. According to a statement made in the British House of Commons by the Financial Secretary to the Treasury in April 1921, the British Government lent £897 millions to Allied Governments during the period in which it was borrowing from the United States, and this was in addition to £828 millions lent to them before the United States entered the War in 1917. "Had the British Government been relieved of the necessity of lending this £897,000,000 to the Allied Governments it would have been, so far as could be judged,

¹ See Table XXX., App.

unnecessary for the British Government to ask financial assistance from the United States Government." The British Government expended in the United States nearly \$3000 million more than the total amount lent during the same period by the United States Governments, mainly on munitions, cotton, cereals, and bills of exchange bought to meet expenditure in the United States.

The loan policy of the United States Government during the

DEBTS OWING TO U.S.A. (August 1923)

Country.	Principal.	Unpaid and Accrued Interest.	Total.
	Million \$.	Million \$.	Million \$.
Great Britain *	4,631	..	4,631
France	3,341	577	3,918
Italy	1,648	326	1,974
Belgium	377	69	446
Russia	193	45	238
Poland	156	26	182
Czechoslovakia	92	18	110
Serbia	51	10	61
Rumania	36	7	43
Austria †	24	4	28
Greece	15	1	16
Esthonia	14	3	17
Finland	9	..	9
Other countries	23	2	25
	10,610	1,088	11,698
Equivalent in sterling (par of exchange)	2,178	222	2,400

* The Funded Bonds have been delivered to the U.S. Treasury.

† Payment of principal and interest extended for 20 years from 1st June 1923.

years 1917 and 1918 and subsequently is as noteworthy as it was successful. In the first place the flotation of the four Liberty Loans in 1917 and 1918 and the Victory Liberty Loan of 1919 is a permanent wonder to many students of American finance. The total amount issued, according to the Annual Report of the Secretary of the Treasury, was nearly \$21,433 millions, and on 30th June 1922 the amount outstanding was \$17,087 millions. The success of the fourth Liberty Loan in October 1918 ($4\frac{1}{4}$ per cent Bonds of 1933-38), when \$6965 millions were issued, was the greatest financial achievement in the history of any country. It not only reflected the strength of the United States financially,

but also the wonderful War Loan organisation that was perfected by the Central Liberty Loan Committee in each of the 12 Federal Reserve Districts. The leading financial, industrial, commercial, and professional men were on each Central Committee. These committees met daily and had also the assistance of ladies. Similarly cities and villages had their committees, and if the daily returns showed that cities or villages were behind in their allotted quotas speakers of repute were sent to rouse the lethargic in this campaign of education. It is estimated that at the end of the War at least 20 millions, and perhaps even 25 millions, out of a total population of 106 millions were holders of Liberty Bonds. Every effort was made to draw the borrowings from actual savings and to get the securities into the hands of investors. In June 1921, according to reports from banks doing over 40 per cent of the commercial banking of the country, only a very small proportion of the long-term loans, Victory notes, and Treasury certificates were pledged with these banks as security. Secondly, the use of Government paper money was avoided and bank credit used instead. Inflation, which is difficult in war to avoid, was kept to a minimum by (1) the restriction of credit to essentials ; (2) the inculcating of thrift either in the form of payment to the Liberty Loans from current savings or in the eschewing of luxuries of all kinds by taxation. Thirty-two per cent was, moreover, paid from taxation according to the data given in the Annual Report of the Secretary to the Treasury for 1920. The net War expenditure to 30th June 1920 was \$33,455 millions, and the excess of the annual tax revenue over the normal tax revenue was \$10,703 millions. An independent authority estimates these figures at \$35,428 millions and \$11,819 millions respectively. Thus one-third of the cost of the War was obtained from revenue and two-thirds from loans, a striking contrast with many leading European countries, and this at a time when Federal revenues were completely changed by the introduction of income and profits taxation and a Federal estate tax which made the tax system direct and progressive in place of, as an American writer terms it, indirect and regressive. Thirdly, the use of terminable securities with maturities not exceeding thirty years issued every six months at rates just high enough to attract savings was markedly successful. Conversion privileges were also not overlooked. In order that these large Bond issues should not be too

much of a strain on the market, they were preceded by almost monthly issues of floating debt which were to be taken up by Liberty Bonds or payment of taxes. To reduce still further tightness of credit by the concentration of funds in Government Treasuries, and to compensate banks for their trouble, banks subscribing to Government loans held their subscriptions as a credit on Government account until the funds were called for by Government. This was known as "payment by credit". Lastly, a sinking fund of $2\frac{1}{2}$ per cent of the aggregate total of the loans outstanding on 1st July 1920, less the amount invested in foreign Government securities, was established by an Act of Congress dated 3rd March 1919. This was a guarantee which increased the confidence of the investing public and is an interesting example for some other countries to follow.

3. FRANCE

Before the War the French debt was the greatest in the world. Early in 1924 (at the current rate of exchange and including that of the German Reich) France's National Debt was the third largest.¹ It is, however, the burden of the French debt that gives cause in some quarters for anxiety. The expenditure on debt services in France at the present time is 53·8 per cent of the total ordinary expenditure, the charges having increased from 13·5 in the pre-War year. The debt of France is a great and complex problem, and there are plain, very plain, indications that the acquiescent attitude in regard to it is being modified. In June 1924, for example, the new French Government proposed a strict inquiry into the financial position of the country with the object of ensuring the balancing of the Budget, the tightening up and readjustment of taxation, especially direct taxation. The problem is one of raising funds to meet the enormous temporary and permanent obligations which the War has left. The timid slackness in the War of politicians, combined with the brilliant apathy of the Treasury and the pedantic respect for mouldy precedent, are mainly responsible for the problem which has arisen.

¹ Great Britain, £7766 millions; United States, £4715 millions; France, £4134 millions (70 fr. = £1)—at par of exchange, £11,472 millions. See Table XXV., App.

The increase in debt is seen in the following table :

FRENCH NATIONAL DEBT

Year.	Total Debt (Millions).		Annual Debt Charges (Millions).	
	Fr.	£	Francs.	£
1713	1,200	48	..	..
1763	2,750	110	..	..
1793	800	32	..	..
1800	725	29	..	..
1814 (1st April)	1,275	51	75	3
1816	3,500	140	..	..
1830	5,182	207	223	9
1848	6,500	260	1	1
1852	6,639	266	262	10
1868	12,383	495	382	15
1876 (1st January)	19,900	796	750	30
1883	27,401	1,096	1,121	45
1887 (1st January)	24,675	987	850	34
1893	30,313	1,212	1,039	42
1895	25,975	1,039	825	33
1900	27,150	1,086	..	..
1903	30,799	1,232	924	37
1913	33,637	1,315	958	38
1914 (1st July)	34,188	1,367	1,307	52
1919 (1st January)	147,472	5,898	..	..
1920	240,242	9,609	9,442	378
1921	297,368	11,895	11,681	467
1922	316,984	12,679	14,929	597
1923	289,373	11,472	12,008	480

On the 31st of March 1923 the distribution of the debt between fixed or funded debt and floating debt was as follows :

FRENCH PUBLIC DEBT—31st March 1923

Internal debt—	Fr. (Millions).
i. Fixed debt	167,826
ii. Floating	86,008
Total	253,834
External debt—	
i. Fixed debt	18,695
ii. Floating	16,843
	35,538
Grand total	289,372
Sterling at par (F.25·225 = £1) =	£11,472 millions
Sterling at current rate (F.70 = £1) =	£4,134 „

The floating debt is high, although not so high as in the War period.

The present position may best be envisaged by setting out the ordinary and extraordinary receipts of the French Government from the beginning of the War to the end of the year 1919.

FRANCE'S RECEIPTS, 1914-1919

	Billion Francs.	Per Cent.
Ordinary receipts—		
Taxes, Government monopolies and enterprises	31	17
Extraordinary receipts (Loans) --		
(a) Internal debt—		
Consolidated debt	53	28
Floating debt—		
(a) Short-term Bonds and Treasury Bonds	49	25
(b) Bank of France and Bank of Algeria advances	25	
49 + 25 = 74	74	38
25 + 13 = 38	13	
(b) External debt		
Foreign credits	33	17
Loans	160	83
Grand total	191	100

From this table it will be seen that the ordinary receipts from taxes, Government monopolies and enterprises were only 17 per cent, the remaining 83 per cent having been obtained from loans. The proportion of borrowings to taxation in the case of France is very much higher than in the case of Great Britain or America. The floating debt (including advances of the Bank of France and the Bank of Algeria, which may be regarded as in the nature of floating debt) shows the large proportion of this debt relatively to the consolidated debt. Even if the advances of the Bank of France and the Bank of Algeria are not regarded as floating debt the proportion is high.

The table showing the growth of French debt illustrates how the debt grew owing to the extravagance of the monarchy as well as to numerous wars. Even before the Revolution Louis XV. (1715-74) increased the State debt in spite of the assistance of such financiers as Turgot (appointed by the King Controller-General and Minister of Finance in 1774) and Necker (who was

Director-General of Finance in 1788, and the author in 1781 of the well-known *Compte rendu au roi*). Cambon, the Finance Minister under the Revolution, consolidated the debt. All the debt was inscribed in a *grand livre* of the public debt which was taken to be conclusive evidence of the claim. Until February 1796 interest was paid in assignats at their face value. After this date interest was paid in assignats at the rate of 10 francs for each franc of interest due. Assignats were abolished in July 1796. Interest was thereafter paid one-fourth in cash and three-fourths in bills on the national domains. This was, as one writer has pointed out, practically the equivalent of payment to the extent of three-fourths in assignats.¹ In 1797 it was proposed to pay one-third of the service of the debt, or 86 million francs, and to pay off the capital itself of the remaining two-thirds in national domains. The third retained or the "consolidated third" was declared to be "exempt from all stoppage, present or future". The other two-thirds was paid off at the rate of 20 times the annual interest in notes receivable for national domains. As the creditors were required to buy lands these two-thirds constituted a loss to the poor who could not afford to purchase lands. Under Napoleon (1804-18) the finances were set in order by two great men, Gaudin, who is the father of the modern system of French financial administration, and Mollien, Minister of the Treasury in 1806. A biographer describes Gaudin by saying that he "recalled to life that spirit of bureaucracy which, while painstaking and order-loving, as we freely admit, was over-exact to a fault, treating the people as if they were children, incapable of understanding and managing their own interests, and especially of foreseeing what would serve those interests best". In his *Mémoires relatifs à la Révolution, à l'Empire et à la Restauration*² Gaudin gives the secret which guided him: "The spirit of order is the first desideratum in financial administration; it applies to everything and embraces both men and things". The country had never an abler, a more resourceful and yet more prudent and uniformly efficient Minister of the Treasury than Mollien. Both these financiers served Napoleon after "the brow of the Emperor broke through the thin mask of the consul", because, as Goethe said, "under his orders men were sure of

¹ Fisk, *French Public Finance*, p. 194 (Bankers' Trust Co., New York, 1922).

² Paris, 1826.

accomplishing their ends". As proof of this one need only compare the National Debt in 1814 with that of Great Britain, and also the subsequent history of the French debt during the nineteenth century. The smallness of the debt in 1814 on the fall of the Empire as compared with that of Great Britain shows to a great extent the very able administration of financiers like Gaudin and Mollien. During the revolution of August 1830 the indemnity levied on France, the payment to the army of occupation, and the payment to compensate the old nobility increased the debt. Some of the debt was converted in this period as in 1824 in $4\frac{1}{2}$ per cents and in 3 per cents. Five per cent Stock in the third decade of the nineteenth century was no longer the order of the day. The French debt increased during the Orleanist dynasty and under the Second Empire. During the reign of Napoleon III. short wars, such as the Crimean War, the Italian War, and the Chinese War, took place, and in this period also large sums were spent on public works which necessitated large borrowings. In 1852 the 5 per cent *rentes* were converted into $4\frac{1}{2}$ per cents, and in 1862 the $4\frac{1}{2}$ per cents were reduced to 3 per cents. The first conversion resulted in a saving of interest, while the second added largely to the capital of the debt. The war of 1870-71 added 9 billion francs to the debt and increased the annual debt charge threefold. Nearly half of this increase in debt was due to the payment of an indemnity of 5 billion francs (or £200 millions) to Germany. Loans to the extent of 8496 million francs were created between August 1870 and July 1872, and for this the amount received was 6803 million francs, and the annual interest amounted to 400 million francs. Under the Third Republic the public debt of France was again increased, especially by Freycinet, whose scheme for public works, including railways, was very ambitious. Railways, telegraphs and telephones, highways and waterways were constructed from direct loans or subventions from the State or by State guarantees of company issues. In 1883 the conversion of 5 per cent *rentes* into $4\frac{1}{2}$ per cents yielded an annual saving of 34 million francs without any increase in capital. Further conversions were carried out in 1887, 1894, and 1902.

In the pre-War year the debt had increased to 34 billion francs. The increase from 3.5 billion francs at the close of the revolutionary period to 34 billion francs in 1913 may be estimated

to be due to two-thirds from war and one-third on account of the construction of public works such as railroads, canals, docks, sanitary works, and the building of schools.

When the Great War began, the French Government did not obtain the sinews of war from taxes. Before the outbreak of hostilities French finance was abnormal. The Budget did not balance, and above all the system of taxation was much out of date. The income tax, which had been voted a few days before the outbreak of war,¹ was not put into operation until 1916.² When the income tax, War profits tax,³ and the military War tax⁴ were introduced, they were weakly applied, and the receipts from taxation were insufficient for the War and post-War Budget. The laws of December 1916 and 1917 did indeed increase taxation, but not on a scale like that in Great Britain or the United States.⁵

It is interesting to see how this war expenditure was met. A reference should be made to the table on p. 521, where the statistics of consolidated debts, floating debt, foreign credits, and bank advances are given. The War was mainly financed through the advances of the Banks of Issue, short- and long-term National Defence Bonds, and foreign securities. Long-term National Defence Bonds were raised in February 1915, and were to have a currency of ten years, the rate of interest being 5 per cent. In 1917 a new type of Bond was

¹ Law of 15th July 1914.

² Came into effect from 1st January 1916. This was supplemented by the law of 31st July 1917.

³ Law of 1st July 1916.

⁴ Paid by those exempt from military service, and levied as an income tax (law of 30th December 1916).

⁵ The general income tax was increased by the laws of 30th December 1916, 31st July 1917, and 29th June 1918; the War profits tax by the laws of 30th December 1916 and 31st July 1917. The inheritance tax was increased by the law of 31st December 1917. Several assimilated taxes and the securities tax were increased by the law of 30th December 1916. Indirect taxes on alcohol, sugar, light alcoholic beverages, chicory and coffee, vinegar, matches and tobacco (Government monopolies) were increased in regard to matches by the laws of October 1917 and May 1919, and tobacco by laws of 30th December 1916 and January 1918 and May 1919. Postal, telegraph, and telephone rates were increased by the law of 30th December 1916. To the category of new taxes belong the consumption taxes on colonial produce, mineral waters, patent medicines, and amusements (law of 30th December 1916), the tax on commercial payments and luxuries (law of 31st December 1917 and 28th June 1918), and the special tax on goods shipped into and from the country under special licenses (decree of 15th June and law of 29th September 1917). In spite of these increases in existing taxes and the imposition of new taxes, the tax revenue has been quite insufficient.

issued, known as "Obligations de la Défense Nationale", which were to mature at the end of five years. They were in reality redeemable at the end of the first year. The Four Consolidating Loans of the National Defence were floated in 1915, 1916, 1917, and 1918. The first consolidated debt formed a part of the short-term debt in 1915. An unlimited loan was issued in the form of *rentes perpétuelles*, i.e. annuities redeemable at Government option by repayment of the capital sum.¹ The interest was 5 per cent, and the issue price 88 francs. They were not to be redeemed before 31st January 1931. The nominal amount subscribed was 15 billion francs, and the amount realised 13 billion francs, of which nearly half was paid in cash. In September 1916 a similar loan was authorised at 87.5 francs. This loan also was irredeemable before 31st January 1931. The nominal capital subscribed was 11½ billion francs, and the amount realised 10 billion francs, of which more than half was in cash. In October² 1917 a third loan, not redeemable before 1st January 1943, was issued. The rate of interest was 4 per cent, and the issue price 68.6 francs. As in the case of two previous loans, there was no fixed date of maturity. The amount subscribed was nearly 15 billion, and the amount realised 10 billion francs, more than half of which was in cash. The fourth and last Consolidated Loan during the War was issued at 4 per cent, and the issue price of this was 70.8 francs. The redemption was not to take place before 1st January 1944. This loan was a great success, the nominal capital subscribed being 30½ billion francs, and the amount realised being almost 22 billion francs. The payments in cash, however, were only one-third (7 billion francs), the payment in Treasury bills being 13 billion francs. This fourth loan was thus a consolidating loan to a greater extent than its predecessors. The combined result of the four great National Defence Loans was that 55 billion francs were obtained, representing a nominal subscribed capital of 72 billion francs and an annual interest charge of 3 billion francs.

Notwithstanding these loans the position showed that there was the necessity of curtailing the floating debt which had increased from the outbreak of war. The subscriptions to the short-term National Defence Bonds ("Bons de la Défense Nationale") amounted to nearly 30 billion francs. The issue of

¹ Law of 16th November 1915.

² Law of 26th October 1917.

these bonds was authorised by a decree of 13th September 1914. The interest was payable in advance at 4 per cent for the three months' issue, and at 5 per cent for the six months' and one year issues. The ordinary Treasury bills which carried a lower rate of interest were not subscribed for until 1918, when two ministerial decisions increased the interest on them to 3 per cent for those running from one to less than two months, 3·5 per cent for those running from two to less than three months, 4·5 per cent for those running from three months to less than one year, and 5 per cent for those running for one year. In 1919, owing to these provisions, the subscriptions to the ordinary Treasury bills increased to more than 500 million francs.

Advances made by the Bank of France and the Bank of Algeria were 22,400 million francs in the case of the Bank of France, and 395 million francs in the case of the Bank of Algeria, or a total of 22,795 million francs between 1914 and April 1919. These advances were made at the rate of 1 per cent interest for the period of the duration of the War and one year following, and 3 per cent including the amount required for gradual repayment thereafter. The first advance was made in accordance with a law passed shortly after the outbreak of hostilities, which ratified a clause in the convention concluded with the Bank of France on 11th November 1911, whereby the Bank of France bound itself to advance a sum of 2900 million francs to the Government in the event of a mobilisation. The amount of the advance was increased to 6 billions by a convention concluded on 21st December 1914 and ratified by the law of 26th December 1914. This was increased to 9 billions in 1915 (law of July 1915), 12 and 15 billions in 1917 (laws of 16th February and 4th October 1918), and 21 billions in 1918 (law of 7th June), 24 and 27 billions in 1919 (laws of 5th March and 17th July). Similar conventions were concluded with the Bank of Algeria from 6th September 1915, when the advance was increased from a maximum of 200 millions to 300 millions and then to 400 millions (law of 8th October 1918). The Government of France, in addition to short-term and long-term National Defence Bonds, Treasury bills, and loans in the form of *rentes perpétuelles* and bank advances, obtained foreign loans which constitute part of the consolidated debt of the country and a small part of the floating debt. At the end of the first quarter of 1919 the Treasury bills discounted by the British

Treasury amounted to 11,484 million francs, while those accepted by the Bank of England amounted to 1639 million francs. The United States loan operations included the issue of ordinary Treasury bills, a Franco-British loan made in 1915 at 5 per cent, the proportion of France being 1243 million francs, an advance of 10 million dollars made by a group of American banks at $7\frac{1}{2}$ per cent, which amounted to 518 million francs, a credit of 427 million francs from loans of French cities (Paris, Lyons, Marseilles, Bordeaux), and lastly, advances made by the United States Government at 4 per cent, totalling 12,710 million francs at the beginning of 1919. These debts have been already referred to in the paragraph relating to British and the United States external debts.

4. ITALY

The debt of Italy on 30th April 1924 amounted to 93,655 million lire (internal debt) and 22,614 million lire (external debt). The debt was made up as follows :

ITALY'S PUBLIC DEBT

(30th April 1924)

i. Internal debt—

I. Long-term debt—

	Million Lire.
Pre-War debt	12,506
National Loans	36,024
3- or 5-year Treasury Bonds	3,628
7-year Treasury Bonds	4,000
9-year Treasury Bonds	4,000
Loan on account of compensation for War damage to Venice	350
Total	60,508

II. Floating debt—

Treasury ordinary Bonds	22,770
Bank advances, State notes, etc.	10,727

Total	33,497
	350

	33,147
Total internal debt	93,655

ii. <i>External debt (at par of exchange)</i> —				Million Lire.
Great Britain (Treasury Bills Bonds)	.	.	.	14,026
United States (open credits)	.	.	.	8,537
„ (Bonds)	.	.	.	51
Total external debt				22,614

(Source : *Gazzetta Ufficiale del regno d' Italia, supplemento alla*, 19th May 1924 (Ministero delle Finanze), p. 10.)

The public debt rose from 15,705 million lire on 1st August 1914 to 70,599 million lire on 28th February 1919, 108,072 million lire on 31st October 1920, 117,731 million lire on 30th June 1923. It has fallen to 116,269 million lire on 30th April 1924.

The national debt of Italy during the pre-War and the last few years is shown below in million lire :

	Year ended 30th June.			
	1914.	1919.	1920.	1921.
<i>Domestic</i> ---				
Funded	14,840	34,100	52,342	54,973
Floating	879	26,048	22,121	30,062
<i>Foreign (at par)</i> . . . .	..	19,200	20,266	20,958
Total	15,719	79,348	94,729	105,993

Most of the consolidated debt (*grand livre*) is at 5 per cent. In July 1906 the 5 per cent gross (4 per cent net) *rentes* were successfully converted into $3\frac{3}{4}$ Stock, to be reduced to $3\frac{1}{2}$ per cent after 5 years. The demands for reimbursement at par were negligible, and the market value of the Stock was hardly affected, while the saving to the Treasury was considerable. The annual interest charges are shown below :

INTEREST ON DEBT

Year.	Amount in £ (at par) Millions.	Year.	Amount in £ (at par) Millions.
1871	18	1912-13	21
1881	19	1913-14	22
1891-92. . . .	26	1921	26
1899-1900	28	1922	63
1906	23	1923	50

The foreign debt, chiefly held in the United States, is accumulating owing to the non-payment of interest. The Italian Government has repeatedly confirmed its obligations. Public opinion in Italy has demanded that some arrangements should be agreed to by the creditor allies, bearing in mind (1) Italy's financial difficulties ; (2) the fact that money was lent when Italian currency was almost at par ; and (3) the large part of the loan served to pay for war materials and supplies at a rate allowing for large profits. These arguments would equally well apply to Great Britain's debt with America, which has now been funded, but it seems that Italy will be allowed some time to permit of an improvement in her financial position. Italy is a classic instance of the evils brought about by unbalanced Budgets when taxation should have taken the place of loans.

5. JAPAN

The War debt of Japan shows two characteristics. In the first place the loans are, as in the case of India, Canada, Argentina, and other countries, external as well as internal. Japan has benefited by having recourse to foreign countries for her supplies of capital, which Japan itself was unable to provide. In the second place, Japan gained much experience from the Russo-Japanese War, and with steady application the Empire had almost recovered before the outbreak of war in 1914. Her debt during the War years is seen in the following table :

JAPANESE PUBLIC DEBT

Financial Year ended 31st March.	Internal Loans. Amounts outstanding at the End of the Financial Year. Yen (Million).	Foreign Loans. Amounts outstanding at the End of the Financial Year. Yen (Million).	Total Yen (Million).	Debt per Head in Yen.
1914	1054.6	1529.4	2584.1	49.2
1915	991.5	1514.8	2506.3	47.0
1916	1028.0	1461.1	2489.2	46.0
1917	1097.4	1370.2	2467.7	44.9
1918	1159.9	1338.7	2498.7	45.9
1919	1268.8	1311.1	2579.9	46.0
1920	1482.4	1311.1	2793.6	49.3
1921	1819.6	1424.3	3244.0	56.5
1922	2184.8	1359.0	3543.9	61.2
1923	2450.1	1358.6	3808.7	64.9

She has emerged after the World War with her financial position considerably strengthened, although in 1920-21 industrial unrest and economic depression affected adversely her internal prosperity. Japan's national debt dates, it may be noted, from the beginning of the Meiji era, when it was decided to pay the feudal nobles and the Samurai lump sums in commutation or public Bonds from which they would derive an annual income. Bonds of the total face value of 191½ million yen were issued. The Government also took over the debts of the fiefs, of which 21½ million yen was paid in interest-bearing Bonds. Her other initial debts were due to the Satsuma revolt of 1877, public works, naval construction, and fiat currency. The Government of Japan has borrowed and repaid abroad a considerable amount of debt. In 1899, for example, the Government had recourse to the London money market and raised a loan of £10 millions at 4 per cent, £100 being issued at £90. Her domestic loans were placed on a uniform basis carrying 5 per cent interest for a period of 5 years without redemption and then to be redeemed within 50 years. Owing to the war with Russia the indebtedness of Japan grew by 1700 million yen. This additional obligation Government resolved to discharge within a space of 30 years. In addition to this there was a proposal for the nationalisation of 17 railways at a cost of 500 million yen, and this brought the State's debts to 2776 million yen, of which the internal debt amounted to 1110 million yen and external debt 1166 million yen. The sum actually spent on war ¹ and armaments represents 1357 million yen. The national debt has been well managed, and a small increase in recent years as compared with other countries is noticeable. The increase in Japan's debt from 1900, as compared with other countries, will be found in Table XXV. App.

¹ Russo-Japanese War.

CHAPTER XXXVII

THE REPAYMENT OF PUBLIC DEBT

1. REPAYMENT

THE burden of public debt may be lightened in four ways : (1) by repayment ; (2) by conversion ; (3) by repudiation, full or partial ; and (4) by a levy on capital or a special debt redemption levy. Conversion means the converting of debt from one form to another (usually at a lower rate of interest), and is practised in order to lighten the burden of interest charges for the taxpayer. At the present time, repayment, conversion, and partial repudiation or confiscation are being considered in some countries as a result of the large post-War debts. Repudiation, as we shall see, can never be considered.

The proportion of expenditure on debt services to the ordinary expenditure has changed from 12·2 per cent in the pre-War year to 39 per cent in the case of Great Britain, in the United States (Federal revenues only) from 3·2 per cent to 44·2 per cent, in France from 13·5 per cent to 53·8 per cent, in Canada from 10·9 per cent to 33·5 per cent, in India from 12·2 per cent to 15 per cent, and in Japan from 36·9 per cent to 18·4 per cent. These figures show in a striking manner the necessity for the repayment of debt, or converting it at the earliest possible moment, and also for considering the advisability of a capital levy. The best policy is ordinarily to budget for a surplus, which should go to reduce the public debt, a policy that involves high taxation and is therefore frequently disliked by a great majority of taxpayers. There are on record remarkable instances of the repayment of debt. The case of the United States may be quoted, which, during the quarter of a century after the Civil

War, paid off its debt so regularly that it fell from \$3000 millions (£600,000,000) in 1865 to \$1000 millions (£200,000,000) in 1890. In America, it is true, wealth is more widely diffused through the population than in any other country of the world, and people are able to pay considerable sums both in direct as well as indirect taxation. The repayment of debt has been the aim of all well-financed countries since the War. Great Britain, for example, between December 1919 and March 1924, reduced its debt by £650 millions, or practically the equivalent of the National Debt at the outbreak of the War. The redemption of debt has sooner or later to be accomplished, as Hamilton so clearly recognised in enunciating his twelve propositions referred to in a previous chapter. The Professor of Political Economy in London University (Prof. Cannan), in his evidence before the Colwyn Committee on National Debt and Taxation, stated that a steady redemption of debt could be secured within so short a period as thirty-five years by the establishment of a sinking fund of £100 millions per annum. He proposed that this should be achieved partly by the reduction of expenditure and partly by increased taxation. This plan, however, is very similar to the idea of a capital levy, although it approaches it by means of a heavy sinking fund. It would lead to an excessive strain on the taxpayer and would result in deflation. Another witness ¹ before the Committee suggested that the amount of redemption should have some relation to the amount of capital saved annually after allowing for the normal increase of population and the replacement of capital. To redeem debt at a greater rate than this would, in the opinion of this witness, have meant cancellation and not repayment of debt. The advantages to a country which repays its debt systematically can scarcely be exaggerated. The value of the securities reflects the credit of the country. Redemption of a debt by purchase at the market rate tends to bring up, as the history of British Consols ² shows, the stock to par. Partial repudiation occurs when Governments inflate currency to a large extent, as in Germany in 1921.

¹ Mr. A. M. Samuel, M.P.

² The lowest quotation for Consols was 47½ on 20th September 1797, and the highest was 114 in 1896.

2. CONVERSION

The process of converting public debts from a higher to a lower rate of interest is followed by all financially sound countries, which are always on the alert to see (1) whether conversion is feasible, and (2) to what extent the rate of interest may be reduced in order to effect a saving in debt charges. For this purpose the price movements of Government Stocks free from liability to redemption, the Stocks of foreign and colonial governments, large municipalities, etc., have to be studied. At the present time it is absolutely essential to take every possible step to reduce the annual debt burden in the form of interest to a minimum.

The first measure of conversion in the British debt belongs to Walpole, although carried out by Stanhope, his successor as Chancellor of the Exchequer in 1717. In 1714 the legal rate of interest for private transactions, which had been fixed at 6 per cent in the year of Restoration, was reduced to 5 per cent,¹ but the greater portion of the National Debt still carried interest at 6 per cent. Borrowing at lower rates was not considered possible, owing to the doubtful security of the throne on account of Jacobite tendencies, and the irregularity in the payment of debt. Walpole saw, however, that material advantages could be gained by conversion, and with the reduction of interest from 6 to 5 per cent, a rise in the price of Stocks took place. The savings thus effected amounted to £329,000. A similar opportunity of effecting a conversion was considered in 1737, but was not supported by Walpole, who did not wish to alienate his capitalist supporters. Previous to this, much of the 5 per cent debt had been reduced to 4 per cent through the assistance of the Bank of England and the South Sea Company. Some amounts had been borrowed even at 3 per cent. In 1749,² when Pelham became Chancellor of the Exchequer, the holders of 4 per cent securities amounting to nearly £58 millions were given the option of interest at 4 per cent for one year, followed by 3½ per cent for seven years (during which no reduction would take place), with a further reduction to 3 per cent after this period. Holders of Stock were given three months to make up their minds. At the end of this period more than two-thirds

¹ Act 12 Anne Stat. 2, c. 16.

² Act 23 Geo. II. c. 1.

of the 4 per cents were converted, *i.e.* £39 millions. An additional three months were granted to holders of non-converted 4 per cents,¹ which brought in an additional £15½ millions. The remaining £3½ millions were redeemed at par by a new loan. This conversion of 1749 yielded an immediate saving of £272,000, increasing to £544,000 in seven years. In 1818 Mr. Vansittart converted £27 millions of Stock from 3 into 3½ per cent in order to obtain from the holders an advance of £3 millions without adding to the capital of the debt. This form of conversion is exceedingly rare. In 1822 he converted Stock offering £105, bearing interest at 4 per cent, in exchange for £100 of 5 per cent Stock. Holders of nearly £150 millions accepted, leaving less than £3 millions of the Stock to be paid off, and the annual saving was £1,197,000. The new 4 per cent Stock was made irredeemable for seven years.² There were other 4 per cent Stocks amounting to £76 millions, which were not secured against redemption, and in 1824³ a convenient opportunity was found to offer the holders of Stock in exchange 3½ per cent Stock irredeemable for five years. The offer was accepted as regards £70 millions and the remaining £6 millions was paid off, the annual saving being £381,000. In 1830 the guarantee given to the 4 per cent Stock of 1822 had expired, and the Stock stood at 102½. Mr. Goulburn decided to offer in exchange for each £100 of Stock either £100 at 3½ per cent Stock irredeemable for ten years, or £70 of a 5 per cent Stock irredeemable for forty-two years, both these options being approximately of the same value.⁴ Over £150 millions of Stock was converted almost entirely into 3½ per cent Stock. The balance of less than £3 millions was paid off and an annual saving of £754,000 was effected. In 1844 Mr. Goulburn again converted £249 millions of Stock. At this period the funded debt consisted almost entirely of 3 and 3½ per cents, with a small amount of 5 per cent Stock created in connection with the conversion of 1830. The holders of the 3 per cents were offered in exchange a new Stock bearing interest at 3¼ per cent for ten years, and 3 per

¹ Act 23 Geo. II. c. 22. Under the latter Act three months more were allowed to the stockholders who did not convert under the previous Act, but the terms were somewhat different. The period of 3½ per cent interest was in their case to last for five and not seven years.

² Act 3 Geo. IV. c. 9.

³ Act 5 Geo. IV. c. 24.

⁴ Act 2 Geo. IV. c. 13.

cent for the following twenty years.¹ Only £103,000 had to be paid off at par. The annual saving in interest was £622,000 for ten years, and double that amount for subsequent years. In 1853 Mr. Gladstone attempted to extinguish a small group of 3 per cents amounting to £9½ millions, which were outside the main 3 per cents.² The option of exchanging £100 Stock for either £82-10 of 3½ per cent Stock guaranteed for forty years, or £110 at 2½ per cent Stock guaranteed for the same period, or for Exchequer Bonds at par, did not prove successful. Only £1½ millions were converted, and the remaining £8 millions had to be paid off at par, with some loss of capital, as the current market price of the 3 per cents was less than par. This failure was due to the disturbing effects of approaching war in the Crimea. This conversion forms the nucleus of the 2½ per cent Stocks of subsequent years. In 1884 Mr. Childers made an unsuccessful attempt to convert 3 per cents amounting to £600 millions into 2¾ and 2½ per cents, both irredeemable for twenty-one years.³ Only £22 millions were thus converted, and even of this one-half was held by Government authorities. Goschen, in 1888, seized the golden opportunity for a great scheme of conversion as evidenced by the prevailing market conditions. He offered to holders of 3 per cent Stocks, which amounted to £558 millions, an exchange at par into a new Stock bearing interest at the rate of 3 per cent for the first year, 2¾ per cent for the next fourteen years, and 2½ per cent for twenty years thereafter, *i.e.* until 1923, when the Stock was to be redeemable at the option of Government. Holders of the new 3 per cents had to accept this conversion or accept being paid off at par, as they were not entitled to notice. It was made optional to holders of the other Stocks, and a bonus of 5s. per cent was offered to them to forgo their right of notice.⁴ The conversion of the Consols and the reduction to 3 per cent were facilitated by a commission paid to stockbrokers, bankers, agents, and solicitors. The brokerage, however, was small in comparison with the Stocks presented, namely £234,000, representing Stocks to the amount of over £312,000,000. The terms of Goschen's redemption scheme were accepted by all holders of the new 3 per cent and by the great majority of the holders of Consols

¹ Acts 7 & 8 Vict. cc. 4 and 5.

² Act 47 & 48 Vict. c. 23.

³ Act 16 Vict. c. 23.

⁴ Act 51 Vict. c. 2.

and reduced 3 per cents, the amount left outstanding being only £42 millions. An Act was passed providing for the redemption or conversion of the outstanding Stock at the expiry of the statutory notice. All the funds required for further operations were raised by Treasury bills and Exchange Bonds, by temporary advances, and by the creation of an additional half-million of the new Stock. In the end it was necessary only to pay off £19 millions. The final result of the whole conversion was an annual saving in interest of £1,412,000, which increased to twice that amount after fourteen years. In 1921 a $3\frac{1}{2}$ per cent Conversion Loan was issued, when only £148 millions, or 23 per cent out of a total of £632 millions eligible for conversion, were converted at a price equivalent to $61\frac{1}{2}$ for the Conversion Loan. A subsequent offer to convert into $3\frac{1}{2}$ per cent Conversion Loan became more popular and brought up the sum to £683,600,000. The latter conversion was effected at the price of $73\frac{1}{2}$. In April 1924 holders of 5 per cent War Loan were invited to exchange their Stock up to an amount of £200 millions into a $4\frac{1}{2}$ per cent Loan, redeemable in 1940-44. At the rate of £100 War Stock for £103 of Conversion Loan, £150 millions were converted.

As already noted, conversion is followed in other countries, notably the United States, for example in 1871, 1873, 1876, 1877, 1878, 1881, and 1882. In France debt conversions have been numerous, and to a considerable extent especially in 1878, 1883, and in subsequent years. In 1880 the 5 per cent in India was converted into 4 per cent Stock. In 1887, 4 per cent was converted into $3\frac{1}{2}$ per cent Stock. In 1895 Sir James Westland when Finance Minister converted Indian debt, with the result that there was an annual saving of nearly Rs.50 lakhs to the revenues of the State, and such instances could be multiplied.

GENERAL PRINCIPLES OF CONVERSION

From what has been said in the previous paragraphs it will be seen that the financier has to keep in close touch with the money market with a view to lightening the annual burden of War debt. It is extraordinary how busy finance departments miss on occasions the psychological moment for making conversions. The British Treasury is in close touch with the Governor of the Bank of England and the City. Similarly the United

States authorities at Washington are in close touch with Wall Street, as New York is only a few hours distant from Washington. In other countries this is not so easy a matter. Simla, for example, is over 1000 miles distant from the financial centres of Bombay and Calcutta, and it is not possible for a finance minister to visit these centres every few weeks, and other means of conveying information have to be found. Nevertheless every effort has to be made to keep in close intimacy with the financial brain or nerve centre of the country. The British National Debt was in 1924 eleven times the pre-War figure. The interest upon the debt required £310 millions per annum, the sterling equivalent of last year's revenue for a rich country like France. This figure, too, is nearly half of the revenue of Great Britain from taxation, and if the debt could be reduced to a 3 per cent basis there would be a saving of something like £100 millions, or sufficient to reduce the income tax by more than two shillings in the pound. The lowering of taxation, therefore, depends in Great Britain and other countries in future years upon the reduction of interest charges by conversion in no small degree. The conversion in the spring of 1924 of £150 millions of 5 per cent War Loan, which might be paid off at any time after five years, into $4\frac{1}{2}$ per cent Stock repayable in not less than sixteen years, showed how close the British Treasury was in touch with the money market. The holders were waiting to surrender at a favourable opportunity a short-term Stock yielding 5 per cent for a moderately long Stock on terms giving a yield of £4 : 14 : 8.

In considering whether conversions should or should not be made, the probable course of interest rates, taxation, and prices has to be kept in view. For large holders, such as insurance companies, banks, and the professional investor, it is necessary to take into account the probable tendency of interest rates in the long run as well as in the near future. The rate of interest is dependent on the supply of and demand for capital. If the demand for capital decreases or the supply increases, interest rates would fall. From the end of 1922 there has been a slight tendency of interest rates in London even on foreign loans to fall, and if interest rates fall in future years the British Conversion Loan of 1924 will certainly prove to be a better investment than that of the 5 per cent War Loan redeemable in not more than five years. The history of the 25 years after the close of the Napoleonic

Wars may be repeated, when the interest basis of the National Debt was reduced, it will be remembered, from 5 to $3\frac{1}{4}$ per cent. If it is likely that a reduction in taxation will take place, say in income tax, and if the value of the pound sterling will increase rather than decrease, then it will be to the interest of the holder of Stock to convert. With an increase in production prices of commodities will tend to fall and taxation may decline.

The capital of the debt in making conversions should not be increased unless for good reasons. Between 1776 and 1785, troublous times for British finance, for £92 millions borrowed no less than £115 millions were to be repaid. In 1797 an internal loan of £1,620,000 was contracted by the British Government, and for every £100 subscribed at 3 per cent, £219 stock was allotted. Many of France's loans in the nineteenth century were issued from $52\frac{1}{2}$ to 84 per cent, one loan in 1848 being as low as 45 per cent. The rate of interest was usually 5 per cent. Similar extravagance was not altogether unknown in the critical days of the Great War.

There are other maxims not to be forgotten. The conversion should be as simple as possible. The conversion scheme of Goschen is a good example. A reduction, for example, in the rate of interest if accompanied by a guarantee against a further conversion for a period will ensure, *ceteris paribus*, a successful conversion. It is also advantageous to consolidate a variety of loans at varying rates of interest into a single debt of uniform interest. Greater uniformity was introduced into the British public debt system in 1751, when several classes of debt were consolidated into one loan bearing a uniform interest of 3 per cent, an operation which gave rise to the term "consols". The anxiety which is relieved by the conversion of floating debt into funded debt and the dangers of an excessive floating debt have already been discussed. It is also worth while for Governments to pay a small commission when conversions are launched to bankers, stockholders, and solicitors, whose clients play so important a part in all these transactions.

3. REPUDIATION—COMPLETE AND PARTIAL

Complete repudiation is rarely, if ever, practised. The Soviet Government of Russia has repudiated all internal and external

obligations of the State. In September 1917, the year of the Revolution, the total indebtedness of Russia was 32,300 million roubles. On 31st March 1921 the indebtedness to Great Britain was, excluding interest since 31st December 1918, £561 millions. If states were to repudiate future loans could not be floated, and it is always probable that defaulting states will be attacked indirectly or directly for not paying their just dues. Considerable economic injury has been inflicted on Russia since 1917 on this account. Even France and Italy, which do not pay interest on their external debt,¹ do not repudiate. "France will not repudiate", said a high financier of France with regard to her external debt. "Only we won't pay for the present." The quick French mind sees all the attendant evils of repudiation. The complete repudiation of an internal debt never arises unless the interest charges are unreasonably high or grave revolution has taken place. Repudiation of external debt does not take place except as a result of war or, as sometimes happens, on account of the desire of the inhabitants to wait till one country pays in order that another country may be paid. It may even arise from an imagined independence of outside assistance after the country in question has for long been dependent on foreign capital. Partial repudiation is seen in the case of Germany and Russia, where excessive inflation by the use of the printing press has lightened the burden of the debt from the State's point of view, and indeed has involved repudiation of debts. Such partial repudiation affects internal creditors (*e.g.* those on fixed money incomes and wage-earners whose earnings rise more slowly than prices), and also external creditors, as the history of the last few years has only too clearly shown.

4. THE CAPITAL LEVY

The growth in public debts and the resulting large demands in the form of interest charges have made the question of the repayment of war debts an urgent one. The problem is to examine whether the injurious economic results of recurring annual taxation are less than the effects of a capital levy. The feasibility of a capital levy will not be denied even by its strongest opponents. The Professor of Political Economy at Cambridge (Professor Pigou) and others have put forward the case why a

¹ 1924.

capital levy should be undertaken in Great Britain in preference to paying off debt over an extended period. The British Labour Party in November 1923 issued their programme, in which it was stated that "Labour condemns the failure of Government to take steps to reduce the dead-weight War debt. No effective reform of the national finances can be attempted until the steady drain of a million pounds a day in interest is stopped. Treasury experts, in evidence before a Select Committee of the House of Commons,¹ expressed their view that a tax on War fortunes could be levied, and have, therefore, admitted both the principle and its practicability." The Chancellor of the British Exchequer appointed in 1924 a strong Committee to examine this subject, which really resolves itself into two main questions: (1) a question of principle, and (2) a question of technique. The Committee, of which Lord Colwyn was appointed Chairman—Lord Colwyn won his spurs as Chairman of the Royal Commission of Income Tax, 1920—was asked "to consider and report on the National Debt and the incidence of existing taxation, with special reference to their effects on trade, industry, employment, and national credit".

The case for and against a capital levy has been ably set out by many writers.² The proposal of the British Labour Party was to have a special levy on accumulated wealth, the limit of exemption being £5000. Beyond this exemption progressive taxation would take place. Capital rather than income would be taxed, and the payment was to be made quickly, but exemptions were to be granted in a small number of cases. The rate of taxation is seen in the following tables:

¹ Cf. *Report from the Select Committee on Increase of War Wealth* together with the *Proceedings of the Committee Minutes of Evidence and Appendices* (102 of 1920).

² The case for a War debt redemption levy is set out in the following books: *Labour and the War Debt, a Statement of Policy for the Redemption of War Debt by a Levy on Accumulated Wealth* (London, 33 Eccleston Square, S.W.1, Labour Party); Pigou, *A Capital Levy and a Levy on War Wealth* (Oxford University Press, 1920), cf. Part IV. chap. xi. *Economics of Welfare* (Macmillan); Dalton, *The Capital Levy explained* (The Labour Publishing Co., London, 1923); Pethick Lawrence, *A Levy on Capital* (London, Allen & Unwin). The case against a War debt redemption levy is set out in the following books: Pennefather, *The Capital Levy exposed* (London, Hutchinson & Co.); Harold Cox, *The Capital Levy, its real purpose* (The National Unionist Association, Westminster), cf. *Report and Evidence of the Select Committee on Increase of the War Wealth* (102 of 1920); *Economic Journal*, March 1919; September 1920, Professor Corrado Gini on the Italian Law.

		Scale of Levy.		Levy Per Cent.
First	£5,000 . .	£0-	5,000	0
Next	£1,000 . .	£5,000-	6,000	5
„	£2,000 . .	£6,000-	8,000	10
„	£2,000 . .	£8,000-	10,000	15
„	£5,000 . .	£10,000-	15,000	20
„	£5,000 . .	£15,000-	20,000	25
„	£10,000 . .	£20,000-	30,000	30
„	£20,000 . .	£30,000-	50,000	35
„	£50,000 . .	£50,000-	100,000	40
„	£100,000 . .	£100,000-	200,000	45
„	£300,000 . .	£200,000-	500,000	50
„	£500,000 . .	£500,000-	1,000,000	55
Remainder	. .	Above 1,000,000		60

This scale would work out as follows :

A man worth not more than £5000 would pay nothing.			Per Cent of his Total Fortune.	
A man worth	£6,000 would pay . . .		£50 or	1·2
„	£8,000 „ . . .		£250 „	3·2
„	£10,000 „ . . .		£550 „	5·5
„	£15,000 „ . . .		£1,550 „	10·3
„	£20,000 „ . . .		£2,800 „	14·0
„	£30,000 „ . . .		£5,800 „	19·3
„	£50,000 „ . . .		£12,800 „	25·6
„	£100,000 „ . . .		£32,800 „	32·8
„	£200,000 „ . . .		£77,800 „	38·9
„	£500,000 „ . . .		£227,800 „	45·6
„	£1,000,000 „ . . .		£502,800 „	50·3
„	£2,000,000 „ . . .		£1,102,800 „	55·1
„	£3,000,000 „ . . .		£1,702,800 „	56·7
„	£10,000,000 „ . . .		£5,902,800 „	59·0

On the analogy of estate duties a law would be passed by which, as one writer phrases it, “every man and woman of a suitable degree of wealth would be deemed to die and to come to life again next morning as the fortunate heir to his or her own property on payment of an appropriate ransom”. Relief will be afforded, it is argued, to trade and industry consequent upon the remission of taxation made possible by the extinction of debt and the cessation of debt interest. This reduction of taxation in future would reduce the bad effects of taxation on production, and would make it possible for money to be devoted to social services, such as education, to an increased extent. A State

levies death duties and gives protection to the accumulation of wealth. For the same reason it has the right to take a part of the capital. It is also argued that it is most unfair that millions of men who fought in the War, perhaps the most enterprising part of the community, must labour to provide interest on money which others were able to lend in large amounts while they were fighting. "If it was right that young men should give their lives, it was right that rich men should give their wealth in taxation, instead of being invited to make a profitable investment."¹ Another argument put forward is that if, as is not unlikely, a general fall in prices takes place, the burden of debt will increase, and the holders of Government securities will gain still more at the expense of the taxpaying community. Therefore it is held a levy is expedient. The effect on the money market of a capital levy is said to be exaggerated by bankers and similar opponents of the measure, since the payment is spread over a period and the Treasury pays the money out as fast as it gets it in. This last argument especially will require careful examination.

With a capital levy as a means of effecting the better distribution of wealth we are not concerned. The proposal must be examined from the financial standpoint. Is it an efficient means, as compared with annual taxation, to reduce public debt? The proposal is not a new one, for in 1716 Hutcheson proposed in the House of Commons that 10 per cent on all property, including the debt itself, should be levied in order to repay debt.² Hume³ and McCulloch,⁴ in commenting on this, held that the poor would not pay, that it would be unfair, and that evasion would be easy. The proposal to repay debt in this manner seems to occur after every great war or calamity. It will, therefore, be necessary to examine (1) the operation of capital levies in other countries, and (2) to review the available statistical data regarding this difficult question, with special reference to Great Britain.

A levy for economic ills has been tried in several countries, notably in Poland, in Czechoslovakia, Italy, Germany, Austria, Hungary, and Greece. It was also proposed towards the end of

¹ *Labour and the War Debt*, p. 5 (The Labour Party, 33 Eccleston Square, London, S.W.1).

² *A Speech made in the House of Commons, 24th April 1716*, by A. H. (1716; 2nd edition, 1722).

³ *Essay on Public Debt*.

⁴ *Taxation and the Funding System*, p. 464 (London, 1845).

1923 in Switzerland. With the exception of Switzerland, the levy was tried as a desperate remedy.

In Poland, by a law of 16th December 1921 and by a new scheme introduced in August 1923, a capital levy has been twice imposed. Wealth in Poland, as is well known, is more unequally distributed than in perhaps any other country of the world. There are family estates, it is said, equal to English counties, whose owners buy racehorses in England in spite of the adverse exchange, and, as has more than once been pointed out, the annual income of this class is probably equal to the total wealth of thousands of their poor compatriots. The result of the Polish levy is that it has produced far less per head of population than the British income tax and super tax, £1 : 8s. for the Polish capital levy against £8 : 10s., the revenue from property incomes and super tax in Great Britain. The levy in 1922 brought (in Polish currency) seventy milliard marks. The gain to the State was wiped out by the subsequent depreciation of the currency.¹ An able Finance Minister was the means of introducing the levy into Czechoslovakia in 1920. The levy was divided into two parts : (1) the capital tax on the total value of the property as on 1st March of the previous year (1919), and (2) the increment tax levied on the increase between 1st January 1914 and 1st March 1919. The levy was made payable within three years, and it was increasingly difficult to collect the tax as time went on. The rate varied from 1·2 per cent to 13 per cent, and property below 3000 gold francs or £120 was exempt. The tax has been in effect a tax on property, payable chiefly from income, and may be taken to be a kind of super tax rather than a levy on capital. The President of Czechoslovakia remarked that "I am not satisfied with the result. The money seemed to disappear." The levy brought into the Treasury the equivalent of £20 millions, of which only a small portion was from capital. In Italy the capital levy of 1920, which was modified in 1922, is a tax on property distributed over twenty years, and has given rise to considerable difficulties in regard to the valuation of property. The valuation was fixed in 1919-20 at a time when values were fluctuating greatly. In Germany, Erzberger attempted (1) a levy on capital, and (2) a non-recurring war levy on increases in

¹ The Polish Government propose to substitute for the levy another tax, and for this a spirits monopoly will shortly be introduced. (Sept. 1924.)

property values, but its defects were nullified by the rapid depreciation of the mark. Austria's attempts have been somewhat similar. "No salvation", says an authority, "came from this panic measure, and when the League of Nations took over the administration of the country it would have nothing to do with it." In Hungary there was much evasion. "The cautious capitalist", according to an official report of March 1923, "promptly did his best to secure himself against further risk by removing his mobile capital out of harm's way." In Greece in 1923 a capital levy was introduced, the percentage being fixed on each stage of a man's wealth. All national loans and remittances from emigrants, as in Italy, were exempt. The date of the valuation of property was, as in Czechoslovakia, prior to the passing of the Act.

The case of Switzerland in 1923 is similar to that of Great Britain. There was as in Great Britain stringency, unemployment, and a heavy debt. In both countries, however, there was no hopeless condition of the public finances. The purpose of the levy, which was introduced by the Socialist Party, was to provide funds for social reforms. Under the Swiss Constitution any 50,000 citizens may initiate legislation. Both chambers of the legislature rejected the proposal by overwhelming majorities, and the State referendum resulted in 730,584 votes against the proposal and only 109,434 in its favour, and over 86 per cent of the voters on the list went to the poll. All the cantons and all towns with a Labour majority disapproved of the result, which was objected to by a majority of 7 to 1. The minimum wealth to be taxed was to be the equivalent of £3200, at a rate varying from 8 to 60 per cent. In one week it is said the withdrawal of bank deposits amounted to one million francs. Bonds and shares were sold to foreigners, who were exempt, and reinvested in foreign securities. The State funds fell on an average by 2 per cent in one week, and other securities lost 1 per cent of their value. The result of the referendum restored confidence in Switzerland both at home and abroad.

The present British debt of £7766 millions is indeed a large sum, and to repay £3000 millions of debt is not an easy matter. It is interesting to note that the National Debt of Great Britain at the close of the French War (1817) was £850 millions, and the national income was estimated at £400 millions. The ratio of debt to income was therefore $2\frac{1}{2}$ times the income. At the

close of the Great War (1918) the National Debt was £7829 millions, while the national income was £3900 millions. The debt, therefore, was in the proportion of 2 to 1, or slightly lower than in the war which ended a hundred years earlier. If the proportion of debt to national wealth be taken it will be found that the percentage of debt to wealth was 32 in 1817, and 34 in 1919.¹ It is necessary to think in proportions instead of in mere amounts, and, all things considered, the proportions are not very much different from those one hundred years ago.

The levy of £3000 millions that has been proposed would produce a saving annually of £142 millions. From this amount, however, must be deducted about £90 millions on account of losses from existing taxes which that amount of capital and the income from it would produce. Income tax would be less by approximately £30 millions, super tax by £30 millions or more, and death duties from £25 to £30 millions. Thus there would be a loss of from £85 to £90 millions per annum, which would have to be deducted from the figure of £142 millions. Great Britain would have approximately from £52 to £57 millions per annum from the levy. Sir Josiah Stamp's estimates in 1923 agree with these on the whole. His estimate is from £42 to £50 millions per annum, and £70 millions per annum is the estimate of Mr. Dalton, who favours the levy.² We may safely take it that the saving would be in the neighbourhood of £50 millions. Before the Committee on the Increase of War Wealth, Sir Richard Hopkins of the Board of Inland Revenue said that three-tenths of the War wealth levy of each £1000 millions would be paid in War stocks, three-tenths in cash and other securities, and four-tenths by instalments mainly in cash.³ The Board, it is interesting to note, estimated the aggregate of the individual increase of wealth for the whole population of the United Kingdom to be £4180 millions, and that, if the increase in the hands of those persons whose post-War wealth did not exceed £5000 be excluded there remains an aggregate of £2846 millions in the hands of nearly

¹ Cf. Fisk, *English Public Finance*, p. 37 (New York), Bankers' Trust Co., 1920.

² *The Capital Levy explained*, p. 80 (London, The Labour Publishing Co., 1923).

³ Estimate put forward by Sir Richard Hopkins, Board of Inland Revenue. See the *Select Committee on Increase of Wealth (War)*, No. 102 of 1920. The five Memoranda of the Board of Inland Revenue are of much value.

340,000 people. In discussing a capital levy in Great Britain the crippling of direct taxation in the future has to be fully considered, because 97 per cent of the whole is paid by 3 per cent of the population. It has also been urged that to institute a capital levy to pay off debt at 5 per cent when the returns in industry are from 8 to 12 per cent is hardly worth the candle. A saving of 50 millions per annum on £3000 millions is only a saving of 1·7 per cent.

The root objection to a capital levy is its effect on capital and credit. As Montchrétien¹ pointed out over three hundred years ago, "credit is the soul of all commerce". The British Prime Minister, Mr. Ramsay MacDonald, is reported to have said that "if three thousand millions were taken by the State from accumulated wealth and used by the State to pay off its debt, that money would go back into the pockets of the people who now hold the debt. The moment their script is redeemed by cheque, or by pounds, shillings, and pence, the money which finds its way into the pockets of the State's creditors is immediately reinvested through the banks into industry." He is also reported to have said that a new investment goes into industry at 20 shillings in the £ and not 17 shillings as a result of the capital levy. With all due deference to Mr. Ramsay MacDonald it cannot be said that he has strengthened his position by this half-told tale, although his lucid presentment of the case for change acts as a timely reminder of the need for refurnishing as far as possible our financial armoury. He does not seem to see that there is any difference between the creation of credit and the transfer of credit. Moreover, £3000 millions of cash do not exist. Traders use War debt to finance their business, and if the War Loan were handed over to Government they would be deprived of this. Thus a capital levy would involve a violent deflation of credit, and in the long run a scaling down of wages and prices. Government securities held by banks in the form of Treasury Bills, etc. would not be available for industry for the simple reason that they would cease to exist. Bank deposits would be reduced, and it would be necessary for the banks to curtail their loans. The result of this severe deflation of credit is an equally rapid fall in prices, with loss to industry and dislocation and probably unem-

¹ *Traité de l'économie politique* (1615), "Le credit est l'âme de tout commerce".

ployment. The trade of a country is carried on with the capital in the hands of citizens, and the destruction of this capital, if paid in War debt, would certainly lead to a decrease of credit in the hands of the mercantile community. If the levy is paid in other securities these would probably be kept for sale by Government, in which case they would depress the prices of all securities, or their dividends and interest would be devoted to the payment of interest on War debt.

It appears to be far better to repay debt every year out of a surplus which must be made from income and not from capital. The interest on the internal debt is not a dead loss to the community, as most of it is spent or invested in the country, and this tends to provide wages and lessen unemployment. The effect of a capital levy on London, which is still the money market of the world where large balances are held and utilised, would be great. Once commercial morality is broken by confiscation, money would not flow into the reservoir of capital from abroad, and commerce and industry would then be permanently or at least for a long period affected detrimentally. There are other reasons in addition to these why a capital levy should not be introduced. One of these is that thrift is penalised. Those who have not saved go free, and what is required most of all at the present time is more and more thrift, as this is essential to prosperity. The shadow of uncertain levies discourages the accumulation of capital, and industrial expansion is hindered. If there are two brothers with £10,000 each, and one invests the amount in securities producing £500 per annum, and the other, a bachelor, buys an annuity of £1000 per annum, the man with £500 per annum pays a capital levy and not the other. The former may have pledged his securities to the banks as margin for securing trading operations, and although to some extent these securities would be replaced in the shape of bank credits, this would not be so if National Debt were tendered in payment of levy and cancelled. It is sometimes pointed out that the cost of collection would be high, and it is doubtful whether assessment would be possible except by computing from the income tax returns. On the other hand, the Committee on the Increase of War Wealth were of opinion in regard to a levy on War wealth that although the administration of a tax of this character would involve many difficulties yet these were not insurmountable, and

in the case of Great Britain it was proposed to carry out such a proposal as the Committee put forward. Under this scheme of a levy on War wealth two assessments would have been necessary : on the wealth of " the hard-faced men who have done well out of the War ", (1) at the outbreak of the War, and (2) at a later period. The great advantage of a War wealth levy was that it would have fallen on those from whom exceptional payments could be demanded. The proposal, however, was dropped, and the changes since 1919-1920 would make any such levy at the present time impossible. The inopportuneness of a levy on War wealth at the present time applies equally to that of a capital levy.

The main argument, then, against a capital levy is that the deflation of a country's balance sheet by a sum of say £3000 millions would mean a violent reduction in values. Prices and wages would decrease considerably, the borrowing powers of traders would be reduced owing to the loss of working capital, which gives the taxpayer about 5 per cent, while in the hands of the public it earns a great deal more. At the present time, and for many years to come, the greatest service that a rich man can do is to save money and thus supply capital plentiful and cheap. The War debt is now part of the economic system of a country, and it is very doubtful whether, when a country is settling down in paying its way, a levy on capital should be introduced. As one banker says : "It would be a case of burning your house to roast your pig, and it would be far better to reduce greatly the debt by a sinking fund and to exercise the strictest economy". A levy should be kept only for a time of extreme urgency. Immediately after the War the opportunity was let slip, because a capital levy, to be successful, requires immediate imposition after some exceptional event unlikely to recur, in order to give the investors confidence that the levy will not be levied. An easy money market is essential, and a levy should not be thought of in a period of trade depression. Those who support the idea are apt to forget that the payment of interest on internal debt is largely a problem of distribution, and the psychological effects of the levy are serious. "The greater productiveness of industry", said McCulloch in 1845, "and the greater well-being of the community are the real sinking funds which a wise Government should exert itself to build up and encourage, and this will be best done by

giving all that freedom to industry that is consistent with right and justice.”¹ The Committee on War Finance appointed by the American Economic Association in 1918 with regard to the proposed levy on capital concluded that “there are so many serious objections to the capital levy that we do not hesitate to report that, in our opinion, such a measure has no proper place in a finance plan for a country in the present position of the United States. As an alternative to repudiation in a country on the verge of bankruptcy something can be said for the plan. For a nation solvent and unembarrassed it possesses no attraction.”

¹ *Taxation and the Funding System*, p. 466 (London: Longmans, 1845).

BOOK V

FINANCIAL ADMINISTRATION

CHAPTER XXXVIII

THE PREPARATION OF THE BUDGET

1. THE SCOPE OF THE BUDGET

AN important branch of the science of public finance—financial administration—has received considerable attention during the present century. The study may be conveniently divided into three parts: (1) the preparation of the Budget; (2) its legalisation or, as it is usually called, the voting of the Budget; and (3) its execution or the carrying out of what has been passed by the legislature.

The Budget is undoubtedly the pivot of the administration, and without a Budget based on sound principles, financial disorder, with all its attendant consequences, takes place as surely as night follows day. The word “budget” is derived from the French word “*bougette*”,¹ a case or despatch box in which the Chancellor of the Exchequer kept his papers. The expression was adopted in England in 1763, when the annual statement of the plan of supplies or expenditure and ways and means or income was first called “opening the Budget”. In 1803 the expression was adopted in French financial nomenclature as a substitute for estimates of receipts and expenditure. Financial administration includes not merely the study of the principles which govern the Budget, but also the study of the underlying laws and conventions.

The Budget is an annual statement of expenditure and revenue to meet that expenditure prepared by public authorities, and it usually covers at least two fiscal periods—the closing period and the period to come. A Budget, in short, includes a statement of the receipts and expenditure of the preceding year, an estimate

¹ *Journal of the Royal Statistical Society*, vol. xxix. (1866), p. 325.

of the receipts and expenditure of the ensuing financial year, and proposals as to the ways and means for meeting a deficit or distributing a surplus if any. It is always so framed as to show at least a small surplus of revenue over outlay, a Finance Minister being, as Low, a former Chancellor of the British Exchequer, said, "an animal who ought to have a surplus". The best description of the scope of a Budget in any language is that given in the "American Budget and Accounting Act, 1921".¹ Section 201 of the Act prescribes that "the President of the United States shall transmit to Congress on the first day of each regular session, the Budget which shall set forth in summary and detail :

"(a) Estimates of the expenditures and appropriations necessary in his judgment for the support of the Government for the ensuing fiscal year ; except that the estimates for such year for the Legislative Branch of the Government and the Supreme Court of the United States shall be transmitted to the President on or before October 15th of each year, and shall be included by him in the Budget without revision ;

"(b) His estimates of the receipts of the Government during the ensuing fiscal year, under (1) laws existing at the time the Budget is transmitted and also (2) under the revenue proposals, if any, contained in the Budget ;

"(c) The expenditures and receipts of the Government during the last completed fiscal year ;

"(d) Estimates of the expenditures and receipts of the Government during the fiscal year in progress ;

"(e) The amount of annual, permanent, or other appropriations, including balances of appropriations for prior fiscal years, available for expenditure during the fiscal year in progress, as on November 1 of such year ;

"(f) Balanced statements of (1) the condition of the Treasury at the end of the last completed fiscal year, (2) the estimated condition of the Treasury at the end of the fiscal year in progress, and (3) the estimated condition of the Treasury at the end of the ensuing fiscal year if the financial proposals contained in the Budget are adopted ;

"(g) All essential facts regarding the bonded and other indebtedness of the Government ; and

"(h) Such other financial statements and data as in his opinion

¹ Act, June 10, 1921, C. 18 § 1, 42 Stat. 20.

are necessary or desirable in order to make known in all practicable detail the financial condition of the Government".¹

It is also prescribed in Section 202 of this Act that :

"(a) If the estimated receipts for the ensuing fiscal year contained in the Budget, on the basis of laws existing at the time the Budget is transmitted, plus the estimated amounts in the Treasury at the close of the fiscal year in progress, available for expenditure in the ensuing fiscal year, are less than the estimated expenditures for the ensuing fiscal year contained in the Budget, the President in the Budget shall make the recommendations to Congress for new taxes, loans, or other appropriate action to meet the estimated deficiency.

"(b) If the aggregate of such estimated receipts and such estimated amounts in the Treasury is greater than such estimated expenditures for the ensuing fiscal year, he shall make such recommendations as in his opinion the public interests require."

And also in Section 203 in regard to supplemental grants or deficiency estimates that :

"(a) The President from time to time may transmit to Congress supplemental or deficiency estimates for such appropriations or expenditures as in his judgment (1) are necessary on account of laws enacted after the transmission of the Budget, or (2) are otherwise in the public interest. He shall accompany such estimates with a statement of the reasons therefor, including the reasons for their omission from the Budget.

"(b) Whenever such supplemental or deficiency estimates reach an aggregate which, if they had been contained in the Budget, would have required the President to make a recommendation under subdivision (a) of Section 202, he shall thereupon make such recommendation."

This Act provides for the creation of a bureau of the Budget in the Treasury Department, with Budget officers in departments who prepare the departmental estimates under the direction of the head of the Department, and it gives an admirable statement of the scope of a Budget.

In the legislature, rules concerning the passage of Budgets or

¹ Act, June 10, 1921, C. 18, § 201, 42 Stat. 20. Barnes Federal Code, 1923, cumulative Supplement (Indianapolis, The Bobbs-Merrill Company). Barnes Federal Code, 1919, contains information up to December 1918: the 1923 Supplement refers to the years 1919-1922.

money bills should be ordinarily well-established and so well known that no one can plead ignorance. It may be said in this connexion that the legislature in voting a Budget performs the expressive function of the legislature. It expresses the mind of the elector on all matters which are dealt with in the Budget. It should do something more. It should teach the country what it does not know and should inform it of what is wrong. It is an opportunity, too, of laying before Government grievances and complaints of all kinds. Redress of grievances precedes supplies.

2. THE FINANCE MINISTER AND THE BUDGET

One of the many lessons of the Great War is that there can scarcely be a more patriotic or more far-reaching service to the State than that of presenting a balanced Budget. This necessitates unusual qualities on the part of a Finance Minister. He has to bring to the task of public finance a mind keen and alert, an intelligence trained in the best of schools, a natural capacity for business, a genuine and practical sympathy with various communities, especially the mercantile community, and a keen desire to be up and doing. He must be, as Lord Morley would have said, a paragon. A Finance Minister is not merely a veritable lion of the Treasury, but also a vigilant guardian of the public purse, who upholds the arms of the Government in its annual struggle with the Amalekites in Budget debates. He is something more than a framer of taxes and a manipulator of Budgets. He must never resist the dictates of common sense, and must show a readiness to meet criticism and an anxiety to win his point by carrying conviction that is not always found behind an official waistcoat. His mind, in Emerson's phrase, must be "locked and bolted to results". Wellesley, a former Governor-General of India, once said that the secretaries of the Government of India combined the industry of clerks with the talents of statesmen. The financier must exalt the statesman and eliminate the clerk. He ought not to be selected for political prowess or, worst of all, for mere seniority in a country's service. He would then be no better than a financial mandarin of the Celestial Kingdom, clad in yellow jacket, a peacock feather, and a red button, possessing little or no knowledge of *la haute finance*.

Owing to the advance in statistics in the last two decades,

greater accuracy in the Budget is now possible. There is at hand a greater mass of information regarding the commercial, industrial, and agricultural life of a country than at any moment hitherto. One can hardly believe that in Great Britain until 1802 no regular statement of the finances of the country was published, and until 1822 no balanced annual account of the public income and expenditure was regularly presented to Parliament.¹ In some countries a Finance Minister's duties have been combined with those of other administrative functions, often, if not always, to the country's financial detriment, as he cannot then possess the severe detachment and independence so necessary for the proper discharge of his duties. There was, for example, no Finance Member of Council in the Government of India until 1859, when Wilson's capable hands took the financial tiller. Similarly, Alexander Hamilton's brilliant work in a short life—he was killed in a duel at the age of forty-seven near Weehawken, opposite New York—is a great example of the value of specialisation and independence in this sphere.

3. THE PREPARATION OF THE BUDGET

The executive or the administration prepare the Budget for the legislature. It is unnecessary to give in detail the method followed in various countries. They bear to one another a family resemblance, and it will be sufficient to narrate what actually happens in one country. Take, for example, India. The Budget is presented to the legislature usually four weeks before the close of the financial year, which ends on the 31st of March, so that the whole of the discussion may be completed before the year begins. Various heads of departments prepare their estimates, and in some cases these are taken in hand as early as August of the year previous, *i.e.* six or seven months before the end of the financial year. The returns filled in by administrative officers are in three parts: (a) the revenue and standing charges of a more or less permanent nature, which, though they may vary from year to year, are not dependent on the head of the department. These charges are, for example, the salaries of the permanent establishment and ordinary contingent expenditure; (b) charges which

¹ Anson, *Law and Custom of the Constitution*, part ii. p. 318 (Clarendon Press, 1892).

are fluctuating from year to year, but are not new objects of expenditure. Ordinarily, stores required by the department are of this nature ; and (c) new items of expenditure. The estimates give the actual expenditure of the previous year, the sanctioned expenditure for the current year, and the probable expenditure for the coming year. Explanations are given of increases or decreases, and these are compared with the current year. One of the rules followed in the preparation of these estimates in this country is not to include in the estimates any new charge unless sanctioned by competent authority. The heads of offices submit their estimates to the Administrative Departments of Government at headquarters, which in turn scrutinise the estimates. Part I. of the returns, (a) above, is mainly scrutinised by the Administrative Department and the Accountant-General. The second part, (b) above, is reviewed by the Finance Department and the Accountant-General, the Accountant-General accepting the orders of the Finance Department as final in this respect. The third part of the return is that which receives the most careful scrutiny. The head of the office has to obtain the administrative approval of the department before the expenditure can be placed in the Budget. The Finance Department also scrutinises carefully these new items. The Administrative Departments then forward to the Finance Department memoranda explaining the necessity for each new item of expenditure, in order that these explanations may be placed first before the Finance Committee of the legislature, and then before the legislature itself in a statement of new items showing (1) the cost of the new items and the head by which it should be borne in the Budget ; (2) whether the cost is recurring or non-recurring ; and (3) any explanatory memorandum showing the reasons for this new expenditure. The Accountant-General includes in the preliminary Budget forecast submitted to Government in December these approved items. It is customary in India to have in each province a Finance Committee of the Legislative Council, usually about a dozen strong, with the Finance Member as chairman. It is doubtful how long this custom of having an official finance chairman will continue, as he is bound to criticise on occasions the expenditure of the Government of which he is a member in this respect.¹ The

¹ India's Finance Minister is also of this opinion. Cf. Sir Basil Blackett's remarks, *Legislative Assembly Debates*, 23rd July 1923.

Finance Committee is not provided for in the constitution or in the Rules, while the Public Accounts Committee, which reviews the expenditure after it has been incurred, has a position under the Rules¹ under the Government of India Act. The Finance Committee reflects generally the views of the Legislative Council, but not invariably, and it is always open to any member of the Committee to express his own views in the Legislative Council. When the comparative merits of the new demands have been finally settled and the Finance Department proposes ways and means for meeting these, further progress in the Budget takes place.

The Accountant-General prepares two editions of the Budget : (1) on the basis of the actual eight-monthly figures, and (2) on the basis of the nine-monthly figures. The duty of consolidating the estimates devolves on him for the provinces, the Finance Department deciding which figures shall be taken as final. The second edition of the Budget is prepared by about the second week of February, and important changes based on ten months' actuals are incorporated in the Budget. With the completion of this the preparation of the Budget is ended, and it is ready for presentation to the legislature. Eight months after the beginning of the financial year, usually in November, four sets of figures are available for Budget purposes : (1) the accounts or final figures of the previous year ; (2) the Budget estimates of the current year ; (3) revised estimates for the current year ; and (4) the Budget estimates for the following year.

The Railway Budget in India is at present divided into (1) the ordinary Revenue Budget, (2) the Programme Revenue Budget, and (3) the Capital Budget. The first gives gross receipts and working expenses, the second expenditure from revenue for betterment and renewals, and the third capital expenditure. The Accountant-General Railways forwards the consolidated estimates to the Finance Department in November for inclusion in the Central Budget.

The Government of India Budget, as distinct from the Provincial Budgets, includes, in addition to the expenditure of civil departments, the expenditure of non-civil departments, such as railways and military finance, posts and telegraphs. It includes also expenditure incurred by the India Office, except

¹ Rule 51 of the Indian Legislative Rules.

that portion which is a part of the British Budget, and also of the office of the High Commissioner for India in London, whose estimates are forwarded to the Government of India for inclusion in their Budget. The main object in describing this system, which varies in degree from country to country, is to show at each stage in the preparation of the Budget the checks on expenditure and on accurate forecasting that take place. The narrower the time between the preparation of the Budget and the period to which the Budget refers, the closer will be the accuracy of the forecast. In India, however, the Budget is prepared before the monsoon falls, and there is therefore considerable uncertainty in the finality of the figures. There is usually a very detailed statement, called "the civil Budget estimates", which gives in detail the expenditure for each office in the administration. In Great Britain such a statement is called the "civil estimates" and in the United States "the book of estimates". They are part of the Budget, and are to the legislature of much importance.

4. THE FISCAL YEAR

In the preparation of the Budget there are one or two matters of importance which require further examination. In the first place there is the question as to the period to which the data should refer. Should it be a twelve-month, and should it be the calendar year? Before the War, in some German States biennial Budgets were in vogue, and in one State at least—Hesse—a triennial Budget was presented. In Prussia expenditure on the Army was for seven years at a time. The objection to a period longer than a year is a real one. It removes popular control over the executive and conceals important variations. A period shorter than a year eliminates accidental changes and upsets Administrative Departments. For this reason supplementary Budgets should be avoided, although, as we shall see, not necessarily supplemental grants or, in American phraseology, "deficiency bills".

The date of commencement of the fiscal year varies from country to country. In England from 1508 to 1799 the year ended at Michaelmas (10th October); from 1800 to 1832 the year ended on 5th January; from 1833 to 1854 it ended on 5th January, 31st March, and 5th April. The reform of adopting a

financial year ending on one date, 31st March, was carried out for the first time in the year ending 31st March 1855. In India the present financial year, following that of England, was introduced with effect from 1866.¹ The financial year ending 31st March is not only used in Great Britain and India, but is also in the Dominions, excluding Australia and Egypt, Denmark, Germany, Greece, Rumania, Turkey, and Japan. The American financial year ends as in Australia, Italy, Mexico, Norway, and Sweden (from 1923)—on the 30th of June. The change from the calendar year took place in the United States from 1844. In Ceylon the financial year ends with the 30th of September. Before the War it used to terminate on the 30th of June. The financial year coincides with the calendar year in certain parts of the British Empire such as Jamaica and Trinidad, and in the Argentine Republic, Belgium, Brazil, Chile, Finland, France, Netherlands, Poland, and Switzerland. The selection of the financial year, and the fixing of the date of the presentation of the Budget to the legislature, are determined by administrative convenience. Accuracy in forecasting the revenue of the coming year and finally estimating the receipts and expenditure in the preceding year, are of importance. It was on this account that the Chamberlain Commission in regard to India suggested that the question of the calendar year should be considered or the commencement of the year from the 1st of November. The Provincial Governments were against the change and commercial circles were divided in their opinion, and the Government of India decided in 1923 not to alter the date.² Another point to remember is that the sanction of the legislature should be secured in time for raising taxation and authorising expenditure, and these two considerations should mainly govern the selection of the dates.

France makes a distinction between the fiscal year and the fiscal period (*l'exercice*).³ The fiscal year corresponds to the calendar year, and the annual finance report contains only a small

¹ Cf. the author's *Indian Finance and Banking* (London, Macmillan), p. 328.

² See Resolution of the Government of India in the Finance Department, No. 83 F.D., dated 18th January 1923.

³ *Vide* Plazinski's translation of *René Stourm's Budget* (New York, 1917, D. Appleton and Co.). This is a classical work on matters connected with the Budget. His discussion on the French system will be found on pp. 115 and ff. Cf. also *The Financial Administration of Great Britain* (Willoughby, Willoughby and Lindsay, 1917, D. Appleton and Co.). See pp. 323 and ff., *Royal Statistical Journal*, 1866.

statement of receipts and disbursements during this period, with the opening and closing balances. It is only a memorandum of account. An "exercice" is the official accounting period also corresponding to the calendar year, but it contains all the receipts credited and the expenditure debited to the period whether they are actually paid or actually received in the twelve months or not. The accounts are thus based on payments of services in the year instead of on payments within the year. So far as creditors are concerned the accounts are kept open for five years, and the law fixes the following dates: for the closing of the accounts, the 31st January of the subsequent year; 31st March for auditing and vouchering; 30th April for collection and payment; 30th June for authorising certain expenditure by supplementary appropriations; and 31st July for the rectification of the records. The accounts for the exercice of 1918 were finally closed in 1923. The French method regards each year as possessing a personality of its own, renders comparison between different years easy and accurate, and it attempts to show the real revenue and expenditure of the year, taking into account not merely the Treasury balances but also the amounts transferred to local disbursement officers but unexpended by them. It tries also to show how much of the revenue and expenditure is due to permanent and temporary causes. The main defect, and it is an important defect, in the French system is the delay in the closing of accounts. Some writers appear to hold that this method of accounting is the ideal one, and they censure Governments for not introducing it on the ostensible reason of avoiding more labour for officials. There is, however, as in most matters, another side to the question. In the first place, on the 31st of March any unspent appropriation lapses. It is true that there is a tendency to spend up to these appropriations in some departments by a rush of expenditure in March. This can be obviated by a strict system of control by which the appropriation would not be allowed unless the amount is entirely and genuinely required. Cases have come to light when railways have bought railway sleepers and large quantities of stores necessary in order to avoid these lapses. These are in most countries not large in comparison with the total appropriation, but nevertheless they deserve to be carefully watched. The main objection to the French system is the unreasonable delay which occurs before the "exercice" is complete, a period which

may extend to five years, and when complete figures are available their value is not so much greater than the ordinary receipts and expenditures used in other countries. In France there is the memorandum which corresponds to the accounts in other countries ; but it does not, of course, give details as in the exercise. One writer¹ suggests that most countries could follow the French method by taking accrued assets and accrued liabilities, as in the case of corporations, and close the accounts within a period of eight or nine months after the end of the financial year. There is much to be said in favour of this. At the same time there is the simplicity of the British, American, and other systems. For Governments the object of accounts is not identical with that of corporations, since Governments simply wish to know how much has been spent and how much is on hand, and not so much their total assets and their total liabilities.

5. THE CONTENTS OF THE BUDGET

The next question is whether receipts and expenditure should be gross or net, and to what extent detailed heads of expenditure should be shown. If gross figures are shown, all transactions will ordinarily be placed before the legislature, and serious scandals avoided. On the other hand, if gross figures are given there will be a tendency to swell unduly certain heads of expenditure and income, *e.g.* those connected with commercial services. Where the expenditure in the revenue-yielding departments is low and receipts in the spending departments small, it is the net figures that are of importance. On balance it is preferable to show gross figures, except perhaps in the case of commercial concerns where net figures may be given in the Budget proper with the gross revenue and expenditure data in the form of an appendix. It is preferable to have swollen and exaggerated income and expenditure rather than to avoid showing gross figures, as the vote on the Budget would in these circumstances be considerably impaired, and the more facts placed before the legislature, in the long run the better for the country's finance. Up to the year 1854 Revenue Departments in Great Britain did not put before the House of Commons detailed estimates, charges of collection being deducted by each department from the gross collections. A resolution of

¹ Adams, *The Science of Finance*, p. 206.

the House of Commons dated the 30th of May, 1848 condemned this method. The whole of the revenue derived from taxation after the deduction of payments for drawbacks, bounties, repayments, and discounts is now credited to Government account, i.e. paid into the Exchequer, and the cost of the Revenue Departments is included in the annual estimates.¹

The Budget should be comprehensive, intelligible, and accurate. The heads of revenue and expenditure should be so classified to enable the legislature to discuss all questions of policy and public interest without difficulty, and to record their vote without prejudicially affecting other items of revenue and expenditure. The classification of the heads should be permanent, and no change effected without ample notice, otherwise the real position of the Budget will not be understood. Governments do not ask for more than they require. The Finance Member in the Indian Legislative Assembly said on the 22nd of September 1921: "I have in my department men who, if I would allow them to do so, would be capable of putting up a Budget which would easily defeat the scrutiny and defy the criticisms of the House. They could conceal among the innumerable items which go to make up one Budget a liberal provision of reserves that the House would never detect, and which would relieve one of the embarrassing necessity of having subsequently to produce demands for supplementary grants. But, sir, this is not the spirit in which we frame our Budget. We frame our Budget with the deliberate intention of asking the country for only so much as we really need to spend."² It is unwise to have a system of separate Budgets, as this interferes with the unity of the Budget and precludes a clear grasp of the financial situation as a whole. It may, as stated elsewhere, be possible to give a separate Budget for a very important commercial head such as railways in order to facilitate the running of the department on strict commercial lines. In regard to the question whether any special income should be assigned for any special expenditure, the general principle to be followed is to meet expenditure from general revenues and not to ear-mark any particular source for a special item of expenditure.

¹ May, *Parliamentary Practice*, p. 447, 12th edition (London, Butterworth & Co.).

² *Legislative Assembly Debates*, vol. ii. p. 845.

6. SUPPLEMENTARY BUDGETS AND ESTIMATES

We have condemned supplementary Budgets since they upset the financial period and waste the time of the legislature. Although under supplemental Budgets new facts are brought to the light of the legislature, and corrected if necessary, they produce a general feeling of insecurity in the administration, such as to outweigh all advantages that may be urged in their favour, except in cases of emergency such as the outbreak of a war.

With supplementary estimates or grants, or, as they are termed in France, *crédits additionnels*, or in America, "deficiency bills", the case is otherwise. A supplementary estimate may be either for a grant to a service already approved or for a grant of new expenditure that has arisen since the presentation of the Budget to the legislature. "The need", says May, "for a supplementary grant to an existing service is not infrequently caused by the system in force to ensure the control of Parliament over public expenditure. To provide for the early presentation of the annual estimates, the departments are obliged to compute in the month of November their anticipated expenditure for the ensuing financial year, dating from the coming 1st April. Fallibility must attend calculations which range over sixteen months in advance; and as too large a demand for money is a grave departmental error, the official tendency is to make the demand too small. If the lesser error occurs, to avoid the still greater evil of excess expenditure, recourse of necessity must be had to a supplementary grant."¹ It may be sometimes necessary for departments to apply for excess grants, having expended their appropriations of the previous year. The British House of Commons, on the 30th of March 1849, resolved that "when a certain amount of expenditure for a particular service has been determined upon by Parliament, it is the bounden duty of the department which has that service under its charge and control to take care that the expenditure does not exceed the amount placed at its disposal for that purpose".² Exceptional demands are met by votes of credit which are ordinarily voted before the expenditure is incurred.

¹ May's *Parliamentary Practice*, 12th edition, p. 452.

² *Ibid.* p. 453.

We have seen that the total amount of votes of credit during the War voted by the British House of Commons amounted to £8742 millions. They are used when the extent of the service is unknown. Like other grants, they are available only during the financial year in respect of which the grant is made. Financiers have from time to time condemned supplementary credits. Gladstone, for example, said, "It is a sound principle that one, and only one, estimate of national expenditure should be laid before Parliament during each session; for to render Parliamentary control effectual it is necessary that the House of Commons should have the money transactions of the year presented to it in one mass and in one account". They tend to make for incorrect estimates, and above all are sometimes used to escape the vigilant scrutiny of the legislature in the original Budget. "The practice of deficiency bills", says Adams, "tempts the administration to withhold a complete statement of its needs in the original estimate for fear its estimates may be cut down. The officers of the Executive department may have greater confidence in the willingness of the legislature (or, what amounts to the same thing, in their ability to coerce the legislature) to grant supplemental credits than to vote the entire amount which they recognise as necessary in the original appropriation. This, of course, is an improper method of procedure and a perversion of the theory of deficiency bills, which should be strictly limited to the correction of legitimate or inevitable errors in the original estimates. The legislature, also, or rather the party in power, finds itself exposed to a similar temptation. Suppose, for example, an important election between the voting of the original appropriation and the time when deficiency bills are presented. What is to hinder the legislature from curtailing the appropriations in the regular Budget in order to make a show of economy before the public? Such a policy must of course be followed by unusual appropriations in the form of deficiency bills, but the election meantime has taken place and the party has been returned to power. This is both an undignified and a dishonest procedure."¹

¹ Adams, *Public Finance*, p. 185. This has been modified by the creation of the Budget Bureau in the Treasury by the "Budget and Accounting Act, 1921".

• 7. EXTRAORDINARY BUDGETS

Extraordinary Budgets are sometimes differentiated from the ordinary Budget. This requires great care as there is a temptation to balance a Budget by placing in an extraordinary Budget capital expenditure which ought to be incurred out of revenue. This produces what is sometimes known as fictitiously balanced Budgets. Japan and France, for example, have at the present time extraordinary Budgets. Japan for many years has had the system, and includes under extraordinary receipts proceeds of the sale of State property, receipts from the issue of public loans, local contributions towards expenses incurred by the State for the benefit of certain prefectures, surplus transferred from the extraordinary Budget from the previous year, and funds transferred from special accounts and certain other extraordinary receipts. To extraordinary expenditure belongs expenditure of a special nature, and this includes expenditure on the various departments — Foreign Departments, Finance Departments, Public Instruction, Agriculture, Commerce, and Communications, as well as on the Army and Navy. René Stourin points out that the objections to extraordinary Budgets are that they open the way to subterfuge and offer temptation to abuse. The *Cour des Comptes* of France have time and again pointed out the evils of extraordinary Budgets—especially the practice of charging regular expenditure to extraordinary receipts.

CHAPTER XXXIX

THE LEGALISATION OR VOTING OF THE BUDGET

1. CONSTITUTIONAL CHANGES AFTER THE WAR

THE second stage in financial administration is the passage of the Budget through the legislature. The Budget is the principal means by which the general policy of the Government is controlled. For this the best talent and experience are required. During the discussions in the legislature attempts are sometimes made to get out of the Budget what is not in it, and persistence in this is like second marriage in Johnson's definition, the triumph of hope over experience. The teaching of a Greek writer, a Christian apostle, is in the heat of debate so often forgotten—"Let all bitterness and wrath and anger and clamour and evil-speaking be put away from you, with all malice".

In the twentieth century considerable changes have taken place in the voting of the Budget in not a few countries. In the United States, for example, the Budget and Accounting Act of 1921 remedied what writers on finance complained of, namely, the absence of authority upon fiscal legislation of the President of the United States during the initial or plastic stage of the Budget, and the absence of any constitutional or legal authority of the Treasury to control the estimates submitted by the various departments for Congress. There was, too, in the House of Representatives,¹ divided responsibility owing to the existence of two committees independent of each other, one dealing with expenditure or appropriations and the other with taxation. By this "self-denying Ordinance" of 1921, as it has been aptly

¹ Both the House of Representatives and the Senate deal with the Budget, not the House of Representatives alone.

termed, there was appointed a strong Committee on appropriations, and this, combined with the introduction of a national Budget system, changed the preparation of the Budget to a considerable extent. It is definitely laid down in the Act that "no estimate or request for an appropriation and no request for an increase in an item of any such estimate or request, and no recommendation as to how the revenue needs of the Government shall be met, shall be submitted to Congress or any committee thereof by any officer or employee of any department or establishment unless at the request of either House of Congress".¹ It is also provided that there should be created in the Treasury Department a Bureau to be known as the Bureau of the Budget, which "under such rules and regulations as the President may prescribe shall prepare for him the Budget", and it "shall have authority to assemble, correlate, revise, reduce, or increase the estimates of the several departments or establishments".² The Bureau has, at the request of any committee of either House of Congress having jurisdiction over revenue or appropriations, to furnish the Committee with such aid or information as it may request.³ Budget officers in the various departments of Government were appointed for the preparation of the department's estimates, which have to be revised and submitted by the head of each department and establishment to the Bureau on or before the 15th September of each year. In case of failure "the President shall cause to be prepared such estimates and data as are necessary to enable him to include in the Budget estimates and statements in respect of the work of such department or establishment".⁴ These changes would some years ago have been considered almost impossible.

Similarly in Germany. The Republican Constitution of 1919 has completely altered the system in which the Emperor (Kaiser) and the Federal Council (*Bundesrat*) had a large part in the working of the Constitution. In Germany, before the Revolution of November 1918, social and economic progress had advanced at a far greater pace than political progress. In India, on the other hand, political progress has advanced far more rapidly than social or economic progress. The German Constitution with its President elected every seven years, its Cabinet (*Kollegium*), at the head of which is the Chancellor of the Reich,

¹ Section 206.² Section 207.³ Section 212.⁴ Section 215.

similar to the English Prime Minister, the representatives of the Governments of the different territories, or of substitutes appointed by them who speak and vote in the name of those Governments in the Reichstag, and a Reichstag with its wide powers have greatly affected the financial administration of the country. In the United States the President is elected by the people, and his Ministry or Cabinet are dependent solely upon him and not upon Congress. They have no seats in either House. Not so in Germany. In India a Constitution under the Government of India Act of 1919 is in operation, the structure, policy, and purpose of which are frankly transitory. The preamble of the Government of India Act has expressly declared that the action of Parliament in determining the time and manner of each constitutional advance " must be guided by the co-operation received from those on whom new opportunities of service will be conferred and by the extent to which it is found that confidence can be reposed in their sense of responsibility ". The Central Government is still responsible not to the legislature, but to the Secretary of State for India and the British Parliament. Each Provincial Government has a separate Budget. The provincial subjects are divided into two classes: (1) Transferred, *i.e.* services transferred wholly to the control of the people of India and placed under the charge of a Minister selected out of the elected members of the Legislative Council, and (2) reserved, *i.e.* services which are not transferred to popular control and are therefore in charge of a member of the Executive Council of the Governor. Except certain items enumerated in the Government of India Act,¹ the whole expenditure on transferred and reserved subjects is voted on by the Legislative Council. The Budget estimates for expenditure are placed before the Legislative Council in the form of demands for grants. The legislature has the final say in accepting or reducing the amounts proposed by Government for expenditure on transferred services. The Council may not increase the grant. In reserved subjects, as will be seen below, the Governor can overrule the legislature if the amount sanctioned by it is insufficient to discharge his responsibility for such subjects.² The Governor is also empowered, both as regards reserved and transferred subjects in cases of emergency, to authorise such expenditure as may be in his

¹ Section 80 A (3).

² Government of India Act, 72 D (2) (a).

opinion necessary for the safety or tranquillity of the province, or for the carrying on of any department.¹ The entire expenditure of the Central Government, excluding certain items specified in the Act, is voted on by the Legislative Assembly. The Governor-General in Council can overrule the Legislative Assembly if the expenditure not assented to by it is essential for the discharge of his responsibility.² He can also authorise in cases of emergency such expenditure as may in his opinion be necessary for the safety or tranquillity of British India or any part thereof.³

Thus it will be seen (1) that changes, very important changes, have taken place in the financial administration of many countries, especially since the World War, and (2) that the degree of responsibility may differ in different countries in regard to the voting or the legalisation of the Budget.

2. PROCEDURE IN DIFFERENT COUNTRIES

The method of examining the Budget is not uniform in all countries. The example of Great Britain has been generally followed in the self-governing Dominions and to a great extent in India. It will be convenient, therefore, to review the chief characteristics of the examination by the legislature of the Budget in Great Britain, the United States, and certain other countries. The Chancellor of the British Exchequer, usually in April of each year, lays before the House of Commons (1) a statement of the actual results of the revenue and expenditure in the past financial year showing how far his estimates have been realised, and what surplus or deficit there has been in the income as compared with the expenditure, and (2) a statement of what the revenue is estimated to be in the next year, on the supposition that taxation remains as it was in the past year, and also an estimate of the expenditure in the current year. If the estimated revenue be less than the estimated expenditure, proposals for new or increased taxation are submitted. If, on the other hand, there is a surplus of revenue over expenditure a remission or reduction in taxation may take place. The extent of this is generally the amount of surplus realised in a previous year. After the Speech from the Throne, a speech which contains a reference to the financial

¹ Government of India Act, Section 72 D (2) (b).

² Section 67 A (7).

³ Section 67 A (8).

requirements of Government, the first vote is that the supply be granted. When the formal vote of supply is passed, the House of Commons by a second vote appoints a day on which it will resolve itself into a Committee of the whole House to consider the supplies to be granted. This is known as the Committee of Supply.¹ The Committee examines the Budget submitted by the Executive. The House then resolves itself into a Committee of Ways and Means² to consider the ways and means of raising the money required, and it is in this Committee that the Chancellor of the Exchequer delivers his annual Budget speech. A Committee of the whole House, without the Speaker in the chair, makes it possible for the House to meet in a freer and easier way than under the strict rules of Parliamentary procedure when the Speaker is in the chair. Adams is hardly right when he says that "although as a matter of political right any member of the House of Commons may be present at the meeting of the Committee of Supply or of Ways and Means and participate in the conferences, as a matter of fact none but the leaders commonly attend, and none but the representatives of some party or some faction of a party venture to take part in the discussion. This means that the study of the details of the Budget is committed to a set of men brought together by a process of natural selection, and presumably the men most capable and fit to deal with intricate subjects by virtue of their experience, their talent, and their political position."³ As a matter of fact, many members attend and take an interest in the debate. The Budget must be discussed in the House of Commons, and the discussion in the Committee of Supply lasts for some twenty days when the guillotine is applied. The remaining "votes" are then put to the House without discussion. The Executive is represented inside the House by heads of departments, especially members of the Cabinet. We shall refer below to the relations between the Lower and the Upper House in the British Constitution in regard to financial business. The Lower House has the final voice in regard to all financial measures.

As is well known, the power of voting the Budget has grown gradually. The famous 12th Article of the Magna Charta provides that "no scutage or aid shall be imposed in the kingdom,

¹ May, *Parliamentary Practice*, 12th edition, p. 470.

² *Ibid.* p. 487.

³ Adams, *Finance*, pp. 147-48

unless by the Common Council of the realm, except for the purpose of ransoming the king's person, making his first-born son a knight, marrying his eldest daughter once, and the aids for these purposes shall be reasonable in amount". Clause VI. of the *Confirmatio Cartarum* of 1297 provides that "for no business henceforth will we take such manner of aids, tasks, nor prises, but by the common assent of the realm, and for the common profit thereof, saving the ancient aids and prises due and accustomed". The Stuarts asserted the divine right of kings, and attempted to deny the right of the Commons to vote the Budget. In 1626 an Appropriation Act legalised all previous appropriations. Charles I. attempted to raise forced loans, but the Petition of Rights solemnly declared that no tax should be levied without the consent of the nation, and condemned forced as well as voluntary loans to the Crown. The levy of ship money and the famous trial of Hampden are too well known in English history to be described here. With the Revolution, however, of 1688 the principle of Parliamentary control of the purse triumphed. The private and public expenditure of the Crown were separated, and the right of the representatives of the people to control the purse has never since that time been contested.

The result to-day is that the British Parliament, although in no sense an executive authority, exercises control (1) by legal restrictions, which prevent the Crown or its Ministers from imposing any charge without the consent of Parliament, either in the form of taxation or expenditure on loans, and from maintaining a standing army in time of peace ; (2) by the doctrine of the Constitution, by which supplies are granted annually by the House of Commons, this supply necessitating statutory sanction each year ; (3) by the rule of the Constitution, by which Ministers of the Crown are held responsible to Parliament for any act done by them in their ministerial capacity or for any advice tendered by them to the Sovereign ; (4) by means of the rule by which supply granted must be appropriated to the particular purpose for which it was granted ; (5) by the presence of Ministers in Parliament, so that their actions can be examined and criticised ; and (6) by other means, *e.g.* Parliament may be supplied with information, such as by questions and answers, by royal commissions or committees, and by "command papers", which, with the exception of the annual estimates which are printed by

the order of the House of Commons, are printed on the authority of the department presenting them. In each House command papers are presented without any formality by being laid on the table by the Minister responsible for them, and during a recess these papers may be presented to the House of Lords by delivery to the Clerk of the Parliament or to the House of Commons by delivery to the Librarian of that House, in accordance with the standing orders of both Houses. It is possible for either House, by means of an address to the Crown or of an order of the House, to obtain from any department information connected with the work or administration of such department. In the House of Lords a motion for papers is often laid for the purpose of debate upon a fit subject of public interest, but in the House of Commons this is seldom done. A motion for a return or for information upon any subject may be refused if the making of such return or the giving of such information is considered to be inadvisable in the public interest or involving unreasonable labour or expense. Although it is not possible for any member of the House, except a Member of Government, to propose expenditure, he can move a resolution to the effect that public money might profitably be expended upon purposes specified in the resolution, and if the House agrees to the motion, it thereby commits itself to a general approval of such an outlay. A private member cannot, however, move that a specific sum be granted for a special purpose, as it must emanate from a Minister of the Crown. This is a great safeguard of the taxpayer against what Anson calls "the casual benevolence of a House wrought upon by the eloquence of a private member, against a scramble for public money among unscrupulous politicians bidding against one another for the favour of a democracy. But the rule is not law. Like all other resolutions or standing orders of either House, it is a self-imposed rule, made by a public body for the guidance of its procedure."¹

In Canada checks similar to those in the British Constitution are in force. In accordance with Section 54 of the British North-America Act, "it shall not be lawful for the House of Commons to adopt or pass any vote, resolution, address, or bill for the appropriation of any part of the public revenues or of any tax or

¹ *Law and Custom of the Constitution*, vol. i. p. 272 (Clarendon Press, Oxford, 1909).

impost, to any purpose that has not been first recommended by the message of the Governor-General in the session in which such vote, resolution, address, or bill is proposed". All financial legislation must be recommended by the Crown, and it is based upon estimates carefully in advance under the direction of the Minister of Finance. There are in addition supplementary estimates. At the opening session of Parliament, immediately after communicating the speech from the throne, the Premier makes a formal motion that the speech of the Governor-General to both Houses of Parliament of the Dominion of Canada be taken into consideration. When this has been considered, the Minister of Finance moves the appointment of the Committees of Supply and of Ways and Means. Before the House goes into Committee of Supply the Finance Minister brings down the estimates by message from the Governor-General, and when the message has been read in English and French, the Minister moves "that the said message, together with the estimates accompanying the same, be referred to the Committee of Supply". In accordance with the English constitutional doctrine that the redress of grievances is to be considered before the granting of supplies, this is the time when the opposition party is given an opportunity to discuss all sorts of matters. The Budget is considered in Committee of the whole House upon the recommendation of the Minister of Finance that "the Speaker do now leave the chair for the House to go into Committee of Ways and Means", and in this Committee what is known as the Budget speech of the Finance Minister is made. At the conclusion of the Budget speech the Minister of Finance gives notice that he will move certain resolutions necessary to give effect to his recommendations.

After the estimates are passed through the Committee of Supply, the Finance Minister moves that the House again go into Committee of Ways and Means for the usual formal resolution of granting certain sums out of the consolidated revenue fund of Canada "towards making good the supply granted to His Majesty". These resolutions must be reported and agreed to formally by the House before the bill founded thereon can be introduced. It is not customary for the House to change to any degree the estimates, and no increase in expenditure or any new expenditure not included in the Budget is passed by the House.

After the Finance Bill has been adopted by the Commons it goes to the Senate, and as in Australia, it is invariably the custom of the Senate to return the bill unamended to the Lower House. A supply bill can only be presented for the assent of the Sovereign by the Speaker of the House of Commons. This is done at the close of the session in connexion with the ceremony of the proroguing of Parliament, and the Governor-General signifies through the Clerk of the Senate, in both the English and French languages, the Royal Assent in the following words: "In His Majesty's name, His Excellency the Governor-General thanks his loyal subjects, accepts their benevolence, and assents to this bill". Canada has been taken as an example of the procedure in a self-governing Dominion.

In India in the central legislature the Budget is presented to both the chambers at the same time. The Finance Member presents the Budget to the Legislative Assembly and the Financial Secretary to the Council of State. The Finance Member deals in his speech with the general economic conditions of the country, variations between the budgeted revenue and expenditure, the revised estimates of the year about to close, and the estimates of revenue, expenditure, and ways and means for the coming year. Similarly in the Provinces the Budget is placed before the Legislative Council by the Finance Member. The Budget is not discussed on the date of its presentation. The Budget discussion resolves itself into two parts—(1) a general discussion, and (2) the voting of supplies. The Governor-General allots a day or two for a general discussion of the Budget, which takes place about a week after its presentation. During the general discussion details are not to be brought forward. Section 67 A (3) of the Government of India Act fixes certain subjects as non-votable, but the Governor-General has the power to direct that such items also may be discussed. This he has used to meet the wishes of the legislature. Next follows the voting of supplies. The maximum number of days that can be allotted for this purpose is 15 as against 20 in Great Britain. No single demand can be discussed for more than two days. If the discussion is not finished within 15 days the President disposes of all the outstanding grants by merely putting the grants to the vote without any discussion. From 1923 the practice has been adopted of Government consulting the convenience of the members as to the order

in which the demands are to be put. Each demand is introduced by the member in charge of the department, and the grants are voted by major heads of expenditure. These demands for grants are sometimes reduced by the Legislative Assembly with a view to effect economy and retrenchment. More usually, however, motions for reduction of grants are brought forward in order to elicit information. As in Parliament, redress of grievances precedes supplies. In India there is no Appropriation Act to consolidate and legalise the supplies granted. An Appropriation Act deals with supplies, i.e. grants of expenditure, whereas the Finance Bill deals with revenue or taxation. The Finance Bill is introduced in the Legislative Assembly after formal permission to its introduction has been granted. The Finance Member opens the discussion, and when this is completed the Bill is taken up clause by clause with the schedules. The Finance Bill, when it has passed the Legislative Assembly, is then passed to the Council of State. The Council of State does not discuss in detail demands for grants. It discusses only in detail the Finance Bill which deals with revenue. When the Finance Bill is agreed to by the Council of State it goes to the Governor-General for his assent. It then become law. If the Bill is not assented to, or is amended, it is returned to the Assembly for further discussion. Provision is made under Section 67 (3) of the Government of India Act¹ for a joint sitting of both chambers, but this takes place only after six months. The Finance Bill, however, cannot wait, as taxes may have to be refunded under the Provisional Collection of Taxes Act. The procedure would be, therefore, to get the differences settled by the Assembly's accepting the amendments of the Council of State, or compromising the points at issue in meetings of members of both chambers appointed for the purpose, or to get the Bill passed under certification before the month prescribed under the Provisional Collection of Taxes Act expires.

In the United States prior to the passing of the Budget and Accounting Act of 1921, Congress had large powers in the Budget.

¹ Section 67 (3) reads as follows: "If any Bill which has been passed by one chamber is not, within six months after the passage of the Bill by that chamber, passed by the other chamber either without amendments or with such amendments as may be agreed to by the two chambers, the Governor-General may in his discretion refer the matter for decision to a joint sitting of both chambers: Provided that standing orders made under this section may provide for meetings of members of both chambers appointed for the purpose, in order to discuss any difference of opinion which has arisen between the two chambers".

Since the passing of the Act its powers have not been diminished. The Executive now prepares a Budget for the whole Federal administration, and accepts responsibility for that Budget. There is still a trace of resentment in some quarters of Congress that the legislature has given up power to the Executive, but as time goes on it will be seen that the new Act will do anything but this, and it will make for nothing but good. The legislature will gain rather than lose by this Act. It relieves, for example, individual members from pressure from their constituencies (which may wish expensive hobbies carried out) without interfering with the vote of the legislature. Now these new items have first to be incorporated in the Budget or brought in a special private bill before Congress. The late President Harding called all the heads of departments together and warned them that henceforth there was to be no lobbying, so far as Executive heads were concerned, in regard to grants, on pain of dismissal. The House of Representatives and the Senate examine as rigorously as before the Budget. Congress may and does cut down and alter estimates. The Committee of Appropriations of the House of Representatives and the Finance Committee of the Senate always can summon any administrative head and can call for information. Before the Budget law of 1921 came into force the Treasury simply compiled the estimates for Congress, and then the several committees of Congress did the rest. It was all the more difficult for the Executive, because no members of the Cabinet have seats in either House where they can explain their policy. The Appropriations Committee and the Ways and Means Committee in the Lower House are still separate, but work in closer co-operation than previous to the passing of the 1921 law. This is conducive to sound finance, because concatenation on the part of the legislature, like that of the Executive, is essential.

Both chambers have generally the same powers in regard to the Budget, and if the Senate does not agree with the House of Representatives, the representatives of both Houses get together, and the matter is settled by joint conference Committees. The issues are, in fact, ordinarily settled by compromise, and the Senate's view is usually the one that carries the day. Sometimes, however, as in the surtax question in 1924, when the House of Representatives was insistent on keeping a high rate of tax, the Senate agreed to the principle, and a satisfactory solution was

reached by compromise. A money bill has to be a very bad bill before it fails to pass this test—compromise by both chambers. By Section 7 of Article I. of the Constitution, bills for raising revenue originate in the House of Representatives, but the Senate can, as we have seen, propose amendments. A bill for raising revenue is one for levying taxes in the strict sense of the word, and not one which incidentally brings in money. Section 8 of Article I. provides that “the Congress shall have power to raise and support armies, but no appropriation of money to that use shall be for a longer term than two years”. Section 9 of Article I. provides that “no money shall be drawn from the Treasury, but in consequence of appropriations made by law, and a regular statement of all public money shall be published from time to time”. This clause contains the right of authorising expenditure by the legislature.

It is unnecessary here to outline the discredited legend of the American Revolution and the financial issues involved. The work of the late Professor Herbert Osgood, of Columbia University, and others, not to mention the opening in 1889 of the English public records on the American Revolution to scholars without reserve, has destroyed a false tradition which proved a perennial source of irritation to the American and British peoples. It is now proved to the world that the birth of the American nation, although ostensibly the revolt of Britishers against a British Government on a well-established right of representation in regard to taxation, was in reality “the result of a slow and gradual process by which the peoples of America and Great Britain, while retaining the same fundamental institutions and ideas, were drawn apart owing to the difference of the conditions under which these institutions and ideas were developed”. Not only geographical distance but different environment have produced, as they must, differences in national character without preventing a lasting friendship and sympathy between the two branches of the English-speaking race. If events had not turned out as they did, one thing is reasonably clear, that the British Empire in its present form could never have come into existence. George Washington was the father and founder of the British Empire no less than the father of his own country.

In France the Minister of Finance submits the Budget to the Chamber of Deputies in the form of a law with explanatory

memoranda. It is referred to the Commission of Finance, which consists of about 38 members, of whom one is reporter or chairman. The Commission submit their report after a few months in great detail, suggesting as a rule many changes. The discussion is both general and clause by clause, and when each article is voted upon its annexed schedule giving details of expenditure of different Ministries is also discussed. When this is complete the Budget goes to the Senate, which has its own Commission. This Commission ordinarily discusses the Budget even a few weeks before its formal receipt, as this saves time. It makes its report to the Senate for discussion. When the final form of the law is agreed to between the two bodies it becomes law, and is promulgated by the President of the Republic. Many financial authorities hold that the defects of the French system are the incompetence of the Members of the Commission and the multiplicity of the reports submitted. In this respect the British system is far superior.¹

In France it is interesting to note how the Estates General failed to attain control over the purse, as it attempted to encroach upon the administrative powers of the Crown instead of confining itself to claiming the right of voting the Budget. For a period of 175 years, *i.e.* between 1614 and 1789, the Crown imposed taxation, and it regulated expenditure without the consent of the representatives of the people. In the Decree of 17th June 1789, the National Assembly promulgated the law that in future the right to vote a tax should be vested exclusively in the nation's representatives. This principle has been observed ever since, except in rare instances, as, for example, under Napoleon and in 1848, and again in 1852. Since the latter date the principle has not been broken. The control of the purse in 1789 referred to taxation, but in 1831 the right to regulate expenditure also was definitely established. Between 1789 and 1791 the civil list was separated from the public treasury.

INITIATION OF MONEY BILLS BY THE GOVERNMENT

Reference has already been made to the fact that it is usual in many countries to restrict the power of the legislature to

¹ See Stourm, *The Budget*, Part II. chapter xii. ; Plazinski's translation (New York: D. Appleton & Co., 1917).

refuse or reduce but not to originate or increase supplies or taxation.¹ The responsibility of economising expenditure and taxation is laid on the shoulders of Ministers who are interested in making both sides of the Budget balance. This practice obtains in Great Britain, India, and in certain other countries. As Bagehot well puts it in his *English Constitution*: "On common subjects any member can propose anything, but not on money—the Minister only can propose to tax the people. This principle is commonly involved in mediæval metaphysics as to the prerogative of the Crown, but it is as useful in the nineteenth century as in the fourteenth, and rests on as sure a principle. The House of Commons—now that it is the true sovereign, and appoints the real Executive—has long ceased to be the checking, sparing, economical body it once was. It now is more apt to spend money than the Minister of the day. I have heard a very experienced financier say, 'If you want to raise a certain cheer in the House of Commons make a general panegyric on economy; if you want to invite a sure defeat, propose a particular saving'. The process is simple. Every expenditure of public money has some apparent public object; those who wish to spend the money expatiate on that object; they say, 'What is £50,000 to this great country? Is this a time for cheese-paring objection? Our industry was never so productive, our resources never so immense. What is £50,000 in comparison with this great national interest?' The members who are for the expenditure always come down; perhaps a constituent or a friend who will profit by the outlay, or is keen on the object, has asked them to attend; at any rate there is a popular vote to be given, on which the newspapers—always philanthropic, and sometimes talked over—will be sure to make encomiums. The members against the expenditure rarely come down of themselves; why should they become unpopular without reason? The object seems decent; many of its advocates are certainly sincere; a hostile vote will make enemies, and be censured by the journals. If there were not some check, the 'people's house' would soon outrun the people's money. That check is the responsibility of the Cabinet for the national finance. If any one could propose a tax, they

¹ *Vide May's Parliamentary Practice*, 12th edition, p. 477 (London, Butterworth & Co., 1917).

might let the House spend it as it would, and wash their hands of the matter ; but now, for whatever expenditure is sanctioned—even when it is sanctioned against the Ministry's wish—the Ministry must find the money. Accordingly, they have the strongest motive to oppose extra outlay. They will have to pay the bill for it ; they will have to impose taxation, which is always disagreeable, or suggest loans, which, under ordinary circumstances, are shameful. The Ministry is (so to speak) the bread-winner of the political family, and has to meet the cost of philanthropy and glory, just as the head of a family has to pay for the charities of his wife and the toilette of his daughters. In truth, when a Cabinet is made the sole executive, it follows it must have the sole financial charge ; for all action costs money, all policy depends on money, and it is in adjusting the relative goodness of action and policies that the executive is employed.”¹ In India, neither in the central nor local legislatures can expenditure or taxation take place except on the recommendation of the Executive Governments.² The President of the Council of State in India referred to this as follows : “ I think it will be quite clear to the Honourable Members if they refer to Section 67 A (2) of the Government of India Act, that the framers of that Act have therein given statutory expression to the English constitutional rule that demands for supply must proceed from the Crown ; in other words, the legislature can reduce, but it cannot increase expenditure. That is quite clearly expressed in the Act. If that is so, it seems to me to involve the necessary consequence that taxation, to provide for such expenditure, must also be initiated by the Crown. Indeed, Section 67 of the same Act could be construed in the same way. I think I must therefore rule that an amendment, except by a member speaking on behalf of Government, which has the effect of increasing taxation proposed by the Bill is out of order, unless it proposes taxation by way of equivalent to a tax brought by the Bill under the consideration of the Council. The point is this, that the Crown makes a demand, the Crown proposes taxation, the Council can reduce the demand or the taxation,

¹ *The Works and Life of Walter Bagehot*, vol. v. pp. 255-6, Mrs. Russell Barrington (Longmans, 1915).

² Government of India Act, 1919, § 67 (2) (a), § 67 A (2), § 72 D (2) (c), and § 80 C.

but it can neither increase the demand nor can it increase the taxation, except at the instance of a member of the Government. But it is open to members who desire to vary what I may call the incidence of taxation imposed by the provisions of the Bill, to propose an increase in one item compensated by a corresponding reduction in some other item.”¹

The President of the Legislative Assembly similarly gave the following ruling: “I think it is obvious that the Imperial Parliament intended to confer the same powers and the same restrictions regarding the levy and appropriation of public revenues which it itself enjoys. Neither the House of Commons nor the Legislative Assembly is empowered to increase a demand for a grant. The House of Commons is equally forbidden to increase a tax. That general principle has been laid down many times, and I think that it is one which we ought to apply here. Therefore, those amendments which propose increases of taxation will not be in order.”²

In the Bombay Legislative Council the President referred to the words of the Speaker in the British House of Commons, in 1908, when he said, “In a committee we cannot go any further than the authority given on the recommendation of the Crown. It is one of the protections of the taxpayer. If the Chancellor of the Exchequer tells me and the House that the scheme proposed is a charge on public revenues, I am bound to accept that statement.”³

3. ANNUAL VOTING OF THE WHOLE BUDGET

Certain heads of revenue and expenditure are not voted every year. There is a classic instance in the case of Germany where the military Budget before the War was voted for seven years, and it was therefore not a matter for the annual debate.

In France the great Mirabeau argued in favour of making no tax votable for more than a year except the one devoted to the service of the debt and the civil list. It was not carried, but in the

¹ *Council of State Debates*, p. 526, 21st March 1921.

² *Legislative Assembly Debates*, p. 3719, 19th March 1923.

³ *Parliamentary Debates*, vol. 191, col. 1512.

Constitution of 1791 it was clearly laid down that funds set apart for debt or the payment of the civil list could not be refused or suspended. In 1827 the matter was again considered with a view to dividing the Budget into two parts; the Budget of the Consolidating Fund and the extraordinary Budget. Into the former was to be placed all permanent and fixed services, and new charges of an accidental or temporary nature were to be included in the latter. It was proposed to make the former charges, *i.e.* those against Consolidated Fund, permanent in order to save the time of the Chambers, which might be devoted to the examination of new expenses, but this was not adopted, with the result that at the present time a plethora of detail is given.¹ It is interesting in this connection to remember that in the First Republic and under the First Empire appropriations were voted *en bloc* and by Ministries, during the first part of the restoration and the first part of the Second Empire by Grand sections, at the end of the restoration and once during the Second Empire and by chapters in 1830, in 1853, and since 1869. In regard to the detail in which the Budget should be voted it was necessary to see not only that balance in appropriations between offices and offices or departments and departments in the public services should be preserved, but care must be taken to see that sufficient legislative control prevails. Otherwise the executive may be wasteful in expenditure. Each vote should have a definite and precise meaning or aim, and the compromise between conflicting interests must be followed. The broad services may be divided, as in the civil estimates or book of estimates, into broad heads and chapters or major heads, and those which are votable annually should be separated from those which are voted permanently. In England Parliament provided for the establishment of a Consolidated Fund in 1787. The proceeds of taxation and other sums of money received by the Treasury on behalf of the Crown are carried to the Consolidated Fund. Permanent charges for the service of the State are secured by Statute upon that Fund, which the Treasury is bound to defray according to law. At present the items included under the Consolidated Fund service are the National Debt service, payments to local taxation accounts, the civil list, annuities and pensions, salaries and allowances, courts of justice and payments to the Northern Irish Exchequer, land settlement, the road fund, and

¹ Stourm, *The Budget*, Plazinski's translation, p. 323.

certain other miscellaneous expenditure. This formed in 1923-24 £380 millions out of a total expenditure of £817 millions chargeable against revenue, or 47 per cent.

In India the non-votable items under section 67 A (3) of the Government of India Act may be said to be permanent appropriations. About 50 per cent of the total expenditure in the Central Budget is non-votable. But nevertheless the Governor-General may, subject to all these, get the vote of the Legislative Assembly in certain circumstances. The distinction between votable and non-votable expenditure has given rise to interesting rulings in the Bombay Legislative Council. The Hon. Sir Narayan Chandavarkar, the first President of the Legislative Council, ruled that where the Head of a Department's salary was non-votable, it was not possible to cut down the votable salaries of officers, such as clerks, etc., on the ground that the Head of that Department is unnecessary or unfit or such like reason pertaining to him personally or his office or position. He cited certain rulings in the House of Commons in support. "Where a demand for the establishment of the Lord Chancellor was made in the House of Commons, a reduction was moved in the expenses of that establishment on the ground of the position of the Lord Chancellor, but the Chair ruled: 'It is out of order to do indirectly what can't be done directly. The position of the Lord Chancellor can't be discussed on this vote' (*P.D. H. of C.* 4th Ser. vol. 17, col. 163). So also, when a demand was made for the salaries of the clerks of the House of Lords, reduction was moved on the ground that the House of Lords was obstructive and therefore unnecessary. The Chancellor of the Exchequer, on a point of order, protested that to reduce the salaries of the clerks for the purpose of attacking their master, the House of Lords, was like carrying on war by killing the baggage-bearers. 'A strange thing if we began contest with a great man by cutting down the salaries of his servants.' Upon that the Chair ruled: 'Nothing is really open to discussion on this vote except the duties and salaries of the clerks. I don't think the policy of the House of Lords is open to discussion on this vote. The Committee can discuss only the duties and remunerations of the officials' (*P.D. H. of C.* 4th Ser. vol. 28, cols. 1426 to 1428). Again, on demand made for repayment to the Civil Contingencies Fund of certain miscellaneous advances, Mr. Lloyd George moved a reduction on the

ground of a principle, namely, that the Lord Lieutenant of Ireland's office was a sinecure, but the Chair ruled : ' The salary of the Lord Lieutenant is placed upon the Consolidated Fund ' (i.e. it is non-votable) ' in order that he may not be criticised in this style. The only question into which the honourable gentleman can enter is that of the adequacy of this expenditure ' (Hansard, 3rd Ser. vol. 348, col. 905)."¹ The successor of Sir Narayan Chandavarkar, the Hon. Sir Ibrahim Rahimtoolla, disagreeing with this ruling, held that it could not apply to a transitional constitution with partial responsible government as in India. He ruled : " The late Honourable Sir Narayan Chandavarkar gave the ruling in question on the ground that what you cannot do directly you cannot be allowed to do indirectly. That is a perfectly sound ruling under conditions of complete responsible government which exist in free countries where the whole House is elected and the Government is responsible to the Legislature. We are working under a different system. We are in a transitional stage, and if the Reforms have conceded, as they were intended to concede, some responsibility to the non-official members I think no attempt should be made to curtail it by indirect means. If the Reforms are real, then the responsibility which they concede to non-official members ought in no way to be taken away. I should like to point out to honourable members that the power of creating new appointments and declaring their emoluments as non-votable vests under the Reforms in the Executive Government. They can create any number of new appointments and put them in the non-votable list. The House would then have no voice in regard to the expenditure involved in connection with their emoluments. The effect of a ruling that what is not possible to do directly cannot be done indirectly would be a substantial extension of the powers of the Executive Government and a curtailment of those of the non-official members, with the corollary that the emoluments of the establishments which those newly created appointments required, and which were votable under the Government of India Act, would become non-votable. This would cut at the very root of the powers which have been deliberately conceded to non-official members under the Reforms. I therefore hold that the power which is given to the House can be legitimately used in exercising

¹ *Bombay Legislative Council Debates*, 9th March 1923, p. 935.

control over the Executive Government in regard to non-votable appointments.”¹

The advantages of not discussing the entire Budget annually are that time will be economised and greater justice done to the remaining items. Moreover, when interest on loans is not subjected to an annual vote greater confidence is produced, as credit and stability count for much. On the other hand, expenditure on supply services including new items of expenditure should come under the annual purview of the legislature.

4. THE POWERS OF THE TWO CHAMBERS

The relative powers of the two Chambers have frequently been discussed. A scrutiny of the detailed heads twice over is considered a waste of time by some authorities who want to restrict the powers of the Upper Chamber to a discussion of general principles only. In the British Parliament the lower House only can initiate Money Bills. The House of Commons only can grant supplies. Money Bills cannot be amended by the Lords on their way to receive royal assent. The supremacy of the House of Commons in money matters can be seen from the Speech of the Throne. The King begins with “My Lords and Gentlemen”, but referring to finance he says “Gentlemen of the House of Commons, I have given orders that a statement of the funds necessary for the operations of the year be submitted to you”. While reverting to foreign affairs he again refers to “My Lords and Gentlemen”. A classic instance of this is seen in 1407, when Henry IV. initiated financial discussion in the House of Lords. The Commons objected to this procedure, and the King recognised the principle that the grants were made by the Commons and assented to by the Lords.² In 1625 it was resolved that the rate or tax should not be altered by the House of Lords. In 1678 it was decided that all supplies ought to begin with them. When the Paper Duty Repeal Bill was rejected by the House of Lords in 1860 the House of Commons passed the following resolutions :

“ That the right of granting aids and supplies to the Crown is in

¹ *Bombay Legislative Council Debates*, 6th March 1924, pp. 822 and 823.

² Anson, *Law and Custom of the Constitution*, vol. i. p. 269 (Oxford Clarendon Press, 1909).

the Commons alone as an essential part of their Constitution ; and the limitation of all such grants as to matter, manner, measure, and time is only in them.

“ That although the Lords have exercised the power of rejecting Bills of several descriptions relating to Taxation by negating the whole, yet the exercise of that power by them has not been frequent and is justly regarded by this House with peculiar jealousy, as affecting the right of the Commons to grant the supplies, and to provide the ways and means for the service of the year.

“ That to guard, for the future, against an undue exercise of that power by the Lords, and to secure to the Commons their rightful control over taxation and supply, this House has in its own hands the power so to impose and remit taxes, and to frame Bills of supply, that the right of the Commons as to the matter, manner, measure, and time may be maintained inviolate.” ¹ In 1909 the Finance Bill was not assented to by the House of Lords on the ground that the judgment of the country was necessary. Parliament dissolved, and the country supported the Government measure. The new Parliament passed the Bill, and an Act—the Parliamentary Act of 1911 ²—became law which provided that a Money Bill passed by the House of Commons and sent up to the House of Lords one month before the end of the session is, if the House of Lords does not pass the Bill without amendment within one month after the Bill is sent to it, to be presented to His Majesty and to become an Act of Parliament.

In Canada all Money Bills must originate in the Commons. The Senate may reject these Bills, but cannot amend them. The power of rejection is seldom used. The Australian Constitution forbids the Senate to originate or to amend Money Bills. In the United States the Senate may alter a Money Bill. The Finance Committee of the Senate is a dominating power on the Congress, and full of initiative. It commences working on the Budget about the time when the House of Representatives takes it into consideration.

In the Indian Constitution of 1919 it is provided that the

¹ 115 C, J, 360; 159 H, D, 3, § 1383; cf. p. 517, May's *Parliamentary Practice*, 12th edition.

² 1 & 2 Geo. V. c. 13; cf. p. 397, May's *Parliamentary Practice*, 12th edition.

Budget should be laid before both the Chambers,¹ but that appropriations should be submitted to the vote of the Legislative Assembly.² Standing Order No. 70 of the Council of State also authorised only the presentation of the Budget to the Council of State. Thus in 1921-22 the Budget was merely laid before and not discussed by the Council of State. Clause (3) of Section 67 A of the Act, however, seems to imply that either Chamber may discuss the general principles of the Budget. Accordingly, after the amendment of Standing Order No. 70 of the Council of State, a discussion by that Chamber of the general principles underlying the Budget is permitted, but no votes are taken on demands for grants which are settled only in the Lower House. In regard to money legislation, however, the position is different. The Council of State enjoys in this respect co-ordinate powers with the Legislative Assembly, as no special provision has been made for giving the latter more powers in regard to legislation, financial or otherwise. The analogy of the British Parliament, in which the House of Commons has the final voice in money matters, is not applicable to the Indian Constitution.

In Article 8 of the French Constitutional Law of 28th February 1875, it is laid down that "the initiative and the making of laws rests jointly with the Senate and the Chamber. The fiscal laws, however, must be submitted first to the Chamber of Deputies and voted by the latter."³ The last four words, "voted by the latter", have given rise to much controversy. The Senate argues that these words were inserted merely to prevent the withdrawal of the Budget by the Executive from the supplies immediately after submission. The Deputies argue that the first and the last word on the Budget should rest with them. The issue has not been settled by any constitutional convention, and pressure is brought to bear upon the Senate by submitting the Budget at a late date, and the Senate yields with almost praiseworthy abnegation. Such disputes in France are usually settled by mutual concessions under pressure of time after two or three conferences.

¹ Section 67 A (1).

² Section 67 A (5).

³ Stourm, *The Budget*, Plazinski's translation, pp. 312-13.

5. REAPPROPRIATIONS AND RESERVE FUNDS

The question of reappropriations is an important one, as power to reappropriate involves in most cases the sanction of the legislature. In modern constitutions Governments are given powers of reappropriation usually under rules or otherwise. Thus under the Indian Constitution it is laid down that, after grants have been voted by the Legislative Council, the Finance Department can sanction reappropriation within a grant from one major, minor, or subordinate head to another. In the Report of the Public Accounts Committee based on the Appropriation Report of the Accountant-General every reappropriation from one grant to another, and every reappropriation *within* a grant not conforming to the rules of the Finance Department, should be brought to the notice of the legislature. In some countries "token grants", i.e. demands for nominal sums, the total expense being met by reappropriation, are applied for merely to bring the matter to the notice of the legislature. It is customary also to leave the Executive with certain funds to be used as a reserve and to be accounted for in the next financial period or Budget. Thus in Great Britain there are the Treasury Chest and "Civil Contingencies", and in the Government of Bombay a reserve amounting to Rs.20 lakhs. The system of empowering the Executive to extend grants from this reserve for approved services does not always commend itself to jealous advocates of the powers of the legislature. It should, however, be remembered that this reserve is usually small, and it is essential to have such a sum for unexpected events when the legislature is not in session.

In the American legislature appropriations are divided into three classes — annual, permanent annual, and permanent specific appropriations. Annual appropriations are all those which are not included in the second and third categories. The permanent annual appropriations are those such as salaries of judges of the Supreme Court, salaries of officers whose duties are essential to the carrying on of the Government, payments to the Smithsonian institution, and interest on the public debt, etc., which need not be voted upon annually and be the subject of political controversy. It is unnecessary for Congress to waste time in making these appropriations every year. Specific appropriations are of definite amount, but indefinite as to time of

expenditure. The object of expenditure is designated particularly. Appropriations for the improvement of Government parks are of this nature. All balances of appropriations contained in the annual Appropriation Bills made specifically for the service of any fiscal year, "and remaining unexpended at the expiration of such fiscal year, shall only be applied to the payment of expenses properly incurred during that year, or to the fulfilment of contracts properly made within that year; and balances not needed for such purposes shall be carried to the surplus fund".¹ This does not apply to appropriations known as permanent or indefinite appropriations. Unexpended balances of appropriations, except for permanent specific appropriations and certain specially named grants, are carried to the surplus fund if unexpended after two years.² In 1912 Congress decided that "no specific or indefinite appropriation made hereafter in any regular annual Appropriation Act shall be construed to be permanent or available continuously without reference to a fiscal year unless it belongs to one of the following five classes: 'Rivers and harbours', 'lighthouses', 'fortifications', 'public buildings', and 'pay of the Navy and Marine corps'", or unless it is expressly provided that "it shall continue available beyond the fiscal year for which the Appropriation Act in which it is contained makes provision".³

6. VETO AND CERTIFICATION

It is sometimes thought that the heads of Constitutions, as in the self-governing Dominions and other States, perform duties which could quite well be done by the use of a rubber-stamp. This, however, loses sight of the manner in which financial policy may be modified by the advice given to members of the Executive responsible or by the action taken by the head of the Government himself. He may veto a legislative enactment. The veto, for example, was exercised in Canada in 1873 by the Governor-General in regard to the Oaths Bill. This was disallowed as being *ultra vires* of the Parliament of Canada. The Governor-General of Australia similarly withheld his consent to a proposed Act, and referred it to Downing Street. This was in connection with the

¹ Act July 12, 1870, c. 251, § 5, 16 Stat. 251.

² Act June 20, 1874, c. 328, § 5, 18 Stat. 110.

³ October 24, 1912, c. 355, § 7, 37 Stat. 487.

Australian Navigation Act, 1912. The Act was finally approved, but the delay gave time for reflection regarding the results of the law, so that it has not been put into force in its entirety. In the Indian Constitution the Governor-General¹ and Governors² of provinces possess the power of vetoing legislation, including, of course, finance legislation. In the United States, under Section 7, Article I, of the Constitution, "every Bill which shall have passed the House of Representatives and the Senate shall, before it become a law, be presented to the President of the United States. If he approve he shall sign it, but if not he shall return it, with his objections to that House in which it shall have originated, who shall enter the objections at large on their Journal, and proceed to reconsider it. If after such reconsideration two-thirds of that House shall agree to pass the Bill, it shall be sent, together with the objections, to the other House, by which it shall likewise be reconsidered, and if approved by two-thirds of that House, it shall become a law." If any Bill is not returned by the President within ten days after its presentation to him, it becomes a law. If it is returned within ten days, unless this Bill is passed by both Houses by two-thirds majority, it does not become law. Thus the Soldiers' Bonus Bill of 1924 was re-passed over President Coolidge's veto by an overwhelming majority. In the case of the Immigration Bill the President did not apply a veto, which would obviously have proved ineffective. Presidents Jackson, Tyler, Johnson, and Cleveland employed this veto power. President Cleveland vetoed no less than 413 Bills during the first term of his office, more than two-thirds of which were private pension Bills. The most important Bill vetoed was the Dependent Pension Bill—a measure so vague that it might have led to enormous frauds upon the Treasury. Presidents Adams, Jefferson, John Quincy Adams, Van Buren, William Henry Harrison, Fillmore, and Garfield never vetoed a Bill passed by Congress. Generally, the other Presidents vetoed but few. Washington vetoed 2, Madison 6, Monroe 1, Jackson 9, Tyler 8, Polk 3, Pierce 9, Buchanan 7, Lincoln 3, Johnson 22, Hayes 8, Arthur 4, Benjamin Harrison 19, Cleveland (second term) 42, McKinley 6, Roosevelt 40, Taft 26, and Wilson 26. Bryce says that the American people admire their President because he has

¹ Sections 68 and 69 Government of India Act.

² Sections 81 and 81 A and 82 Government of India Act.

an opinion of his own and is not afraid to enforce it. In all the States of the Union, except one (North Carolina), Bills passed by the two Houses must be submitted to the State Governor for his approval. Should the Bill be returned to the legislature disapproved, it is lost unless re-passed over his veto by a majority of two-thirds, but sometimes larger, in each House. A good governor uses his veto freely, as this is considered in many States to be a test of a governor's judgment and courage. The power of the veto is a negative one. *Veto* (I forbid) was, of course, the expression used by the tribune of the people in nullifying measures under the Roman Republic.

It is sometimes necessary to certify, restore, or authorise. Thus expenditure may be certified, restored, or authorised as a positive Act of the Executive. The House of Commons in 1871 refused to abolish the purchase of commissions in the Army, and this was carried through by Royal Warrant, an Executive Act.¹ Failure to vote the Budget is the counterpart of the right to authorise the Budget, and rarely have legislatures taken this extreme measure. Failure to vote the Budget is always regarded as a sign or even the result of political unrest. King Charles I. held that if the legislature refused to approve the levying of taxes, and thus failed in their duties, the king may act upon his authority by virtue of the divine right of kings. In the famous struggle between Pitt and Fox towards the end of the eighteenth century, Fox managed to secure the adjournment of the vote on subsidies on five or six occasions. "It cannot", he said, "be contested that the Constitution gives to the House the right to refuse the funds; but this is a weapon which the House must use with caution, and only when the public cause imperatively demands such action. I shall always uphold this right." Erskine May rightly says that this weapon is now rusting in the arsenals of constitutional laws. In Prussia, Bismarck carried on the Government for four years (1862-66) without the grant of supplies from the Landtag, but with the support of the Upper House. The funds were required for military reorganisation. When Prussia defeated Austria at Sadowa the effects of Bismarck's policy were clearly demonstrated. Later King William admitted that the Budgets of the years 1862-66 had not

¹ This is published in Appendix I. p. 483, vol. ii., Anson, *Law and Custom of the Constitution* (Oxon University Press, 2nd edition).

conformed with the law.¹ In France in 1877 the Budget was not voted till the 15th December, *i.e.* until a new Cabinet from the ranks of the majority of the Chamber of Deputies was appointed. In the Indian Constitution it is provided that (1) when legislation is refused to be passed by the legislature it may be *certified* by the Governor-General² or the Governor³ of a province. In regard to local legislatures, the Governor can certify only in the case of *reserved* subjects.⁴ (2) When expenditure is refused grants may be *restored*. The Governor-General has this power under Section 67 A (7) and the Governor under 72 D (2) (a). In the case of the Governor, the power granted under this section applies to reserved subjects only. (3) Expenditure can be *authorised* in emergent cases both by the Governor-General and the Governor under 67 A (8) and 72 D (2) (b) respectively. The Finance Member said in the Legislative Assembly that so far as the Governor-General was concerned, 67 A (8) was applicable to authorisation when the Assembly was not in session.⁵ In the case of the Governor, 72 D (2) (b) applies to the carrying on of any department, and the Act does not specify whether it refers to transferred or reserved subjects. The Finance Bill of 1923⁶ was certified, and also that of 1924,⁷ where the Viceroy stated at length the reasons which led him to certify these Bills. The Secretary of State for India (Lord Olivier), in his speech in the House of Lords on 26th February 1924, stated that provision for certification exists in the Constitutions of certain Crown Colonies. In Bengal to a certain extent and in the Central Provinces almost entirely, supplies were refused in 1924. In Bengal some of these were restored under Section 72 D (2) (a). In the Central Provinces the administration of the transferred subjects was temporarily taken over by the Governor under Rule 3 of the transferred subjects (Temporary Administration Rules), and the previous year's expenditure has been restored by the Governor. No new

¹ Stourm, *The Budget*, Plazinski's translation, p. 22 (London: Appleton, 1917).

² Section 67 B.

³ Section 72 E.

⁴ As to what reserved subjects are see Schedule I. (Part II.) and Schedule II. of the Devolution Rules.

⁵ *Legislative Assembly Debates*, vol. iii. p. 4457, 10th July 1923.

⁶ Finance Departments Notification dated 29th March 1923. This was in regard to doubling the salt tax; see p. 65, Budget for 1923-24.

⁷ Finance Departments Notification dated the 28th March 1924; see p. 59, Budget for 1924-25.

expenditure, however, can be undertaken. The reason for entrusting these powers of certification to the Governor-General and to Governors is the fact that the Central or Federal Government is responsible to Parliament and not to the Central Legislature. As this degree of responsibility to Parliament is reduced the certifying powers are reduced, as pointed out by the Secretary, Legislative Department, in the Legislative Assembly, *pro tanto*.¹ In the pre-reform days the official *bloc* enabled the Executive to pass necessary legislation. The authors of the Montagu-Chelmsford Report "began with the fundamental proposition that the capacity of the Government of India to obtain its will in all essential matters must be unimpaired. . . . What we seek is some means, for use on special occasions, of placing on the Statute Book, after full publicity and discussion, permanent measures to which the majority of members in the Legislative Assembly may be unwilling to assent. We seek deliberately, when the purpose justifies us, to depart from popular methods of legislation, and it is obvious that no device which conforms to those methods can possibly serve our purpose. For this purpose we have come to the conclusion that we should employ the method, now familiar to Indian institutions, of maintaining such a number of votes, upon which the Government can in all circumstances rely, as to ensure the passage of the legislation that it requires."² The proposal of instituting Grand Committees to which the Government's essential Bills might be referred to was abandoned in favour of a Council of State with a small official majority, and the power of certification to the Executive. In regard to the power of certification the Joint Select Committee under Lord Selborne on the Government of India Bill remarked, that "it should be understood from the beginning that this power of the Governor-General is real, and that it is meant to be used if and when necessary".³ In the debate on the Government of India Bill in Parliament, Colonel Wedgwood, in suggesting that the power to introduce any legislation should not be too wide, said, "I quite agree that the Viceroy ought not to be deprived of the opportunity of passing legislation which he thinks is essential to

¹ *Legislative Assembly Debates*, p. 4459, 10th July 1923.

² Para. 276, *Report on Indian Constitutional Reforms*, 1918.

³ *Report from the Joint Select Committee on the Government of India Bill* (Superintendent, Government Printing, Delhi), p. 9, Clause 25.

the safety of India or of the British Empire".¹ Lord Meston says, "He (the Viceroy) uses his arbitrary powers. The legislature counters by rejecting his next measure or refusing funds. The bludgeon has to be employed again, and the cumulative process goes on until deadlock ensues and a whirlwind of popular agitation sends everybody scurrying in search of an amended Constitution. When I was describing the arrangements in the provinces I did not deal with this aspect of the case, though it presents itself there with the same features, if with minor emphasis. The Governor's relations with his legislature in regard to reserved subjects differ in degree, but not in kind, from the Viceroy's relations with the Central Legislature in regard to all his business. On paper each of them has a wide discretion and an indefeasible authority. In practice each of them must walk warily indeed if he is to avoid a habit of conflict which may render the whole scheme of reform nugatory. For the Governor the position is eased by the existence of a field in which the will of the legislature is supreme, and where, accordingly, it can exercise its administrative ambitions. For the Viceroy's protection there is no such safety-valve."²

The certification of the Finance Bills in 1923 and in 1924 brought into relief the question of this positive power of the head of the Executive. The key to the understanding of the position is (1) the fact that the Central Executive (the Government of India) is not responsible to the Indian legislature, and (2) the Constitution of 1919 is definitely transitional. The preamble of the Government of India Act, 1919, begins: "Whereas it is the declared policy of Parliament to provide for the increasing association of Indians in every branch of Indian administration, and for the gradual development of self-governing institutions, with a view to the progressive realisation of responsible government in British India as an integral part of the Empire: And whereas progress in giving effect to this policy can only be achieved by successive stages, and it is expedient that substantial steps in this direction should now be taken: And whereas the time and manner of each advance can be determined only by Parliament, upon whom responsibility lies for the welfare and advancement of the Indian

¹ *Parliamentary Debates*, 4th December 1919.

² *The Constitution of India*, Ilbert and Meston, pp. 150-51 (London: University Press, 1923).

peoples : And whereas the action of Parliament in such matters must be guided by the co-operation received from those on whom new opportunities of service will be conferred, and by the extent to which it is found that confidence can be reposed in their sense of responsibility : And whereas concurrently with the gradual development of self-governing institutions in the Provinces of India it is expedient to give to those Provinces in provincial matters the largest measure of independence of the Government of India which is compatible with the due discharge by the latter of its own responsibilities :” The temporary nature of the Constitution, therefore, is not open to question.

CHAPTER XL

THE EXECUTION OF THE BUDGET

1. SCOPE

AFTER the legislation or vote of the Budget adequate machinery is required in order to give effect to the wishes of the legislature. This branch of the subject is known as the execution of the Budget, and includes the collection of the revenue, the services performed by the Treasury or Finance Department, and the method of spending in accordance with appropriations. The important topics of control and audit belong to this branch of financial administration. Control is used in two senses, sometimes in the more technical sense of the control of issues from the Treasury. The Comptroller and Auditor-General, for example, in Great Britain, dating from the Exchequer and Audit Act of 1866,¹ is an official independent of any Government Department and appointed by Letters Patent, and he performs the functions relating to control of moneys from the Exchequer. The departments of Government cannot obtain money without the intervention of the Treasury, and the Treasury in turn cannot meet their requirements or check their expenditure without the Comptroller and Auditor-General. It is he who has to be satisfied that the requisition of the Treasury is in accordance with the Acts which govern the proposed expenditure ; it is he who makes the order, as it were, to open the Treasury chest. The Treasury then requests the Bank of England to transfer the sums required from the Exchequer to the account of the principal Accountant, usually the Paymaster-General, and at the same time requests the Bank to send the authority for the transfer to the Comptroller and Auditor-General, who thus records the issues from the Exchequer. The

¹ 29 & 30 Vict. c. 39, § 3.

word "control" is also used in a wider sense to embrace all forms of control, judicial, legislative, and administrative, over expenditure, receipts, and loans. Thus control in the latter sense would include (1) the administrative control exercised by the head of a department and by the Treasury or Finance Department over other offices, (2) the judicial control exercised, for example, by the Court of Accounts in France, and also (3) the legislative control exercised through the Committee of Public Accounts. By "audit" is meant the verification and examination of accounts before the expenditure takes place (pre-audit) or after the expenditure has been incurred (post-audit). Audit originally consisted of the hearing of explanations from those rendering the account. "The lord of the manor ought to command and ordain that the accounts be heard every year, not in one place, but on all the manors, for so can one quickly know everything and understand the profit and loss."¹ Burke in his well-known speech of 1780, "A plan for the better security of the independence of Parliament and the economical reformation of the civil and other establishments", laid stress on the importance of the execution of the Budget. Three years after his speech the audit of the two auditors of Imprest was found to be nothing short of a scandal. Each auditor was found to be in receipt of £16,000 a year. He was paid by fees and did his work by a deputy.² These auditors were abolished in 1785³ by statute, and a body of five commissioners was appointed for auditing the public accounts. This body, known as the Audit Board, inherited considerable arrears from its inefficient predecessors, but it developed a considerable degree of efficiency in time. Its duties were, however, transferred to the Comptroller and Auditor-General by the Exchequer and Audit Act of 1866, on which the present system of control of issue and audit rested even after the passing of the Amending Act of 1921. Parnell in his pamphlet "Financial Reform"⁴ criticised the methods of control and audit. In 1832, in addition to the cash account, there was introduced an appropriation account, a form of account which has since been applied in Great Britain to every form of expenditure. In 1834 the Exchequer Offices were

¹ From the very remarkable book by Walter de Henley, *Tretyce of Husbandry*, (circa 1200-1250), Cambridge University Library.

² *Report on Public Income and Expenditure*, 1869; cf. Anson, Part II. p. 331.

³ 25 Geo. III. c. 52.

⁴ Published in 1830.

abolished and with them a costly system of procedure and also equally costly sinecures. In 1921 the Exchequer and Audit Department Acts of 1866 and 1889 were amended by the Exchequer and Audit Departments Act of 1921, which provided *inter alia* that stores and revenue accounts also should be audited by the Auditor-General and reported on to the Public Accounts Committee of the House of Commons. Great Britain improved, like many other countries after the Great War, its financial system, especially in regard to the effective carrying out of the Budget. The United States, by an Act of Congress passed in 1921,¹ created a General Accounting Office "which shall be independent of the Executive departments and under the control and direction of the Comptroller-General of the United States". This was to take the place of the Offices of the Controller of the Treasury and Assistant Controller of the Treasury. It was also provided that "there shall be in the General Accounting Office a Comptroller-General of the United States, who shall be appointed by the President with the advice and consent of the Senate".² This Act clearly shows the importance of this branch of the administration, as it lays down the scope of the Comptroller-General's work thus: "(a) The Comptroller-General shall investigate, at the seat of Government or elsewhere, all matters relating to the receipt, disbursement, and application of public funds, and shall make to the President when requested by him, and to Congress at the beginning of each regular session, a report in writing of the work of the General Accounting Office, containing recommendations concerning the legislation he may deem necessary to facilitate the prompt and accurate rendition and settlement of accounts, and concerning such other matters relating to the receipt, disbursement, and application of public funds as he may think advisable. In such regular report, or in special reports at any time when Congress is in session, he shall make recommendations, looking to greater economy or efficiency in public expenditures."³ It is also provided that "all departments and establishments shall furnish to the Comptroller-General such information regarding the powers, duties, activities, organisation, financial

¹ Budget and Accounting Act, 1921; Barnes U.S. Statutes Cumulative Supplement, 1923, p. 18.

² Act 10th June 1921, C. 18, §§ 301 and 302, 42 Stat. 20.

³ Act 10th June 1921, C. 18, § 312, 42 Stat. 20.

transactions, and methods of business of their respective offices as he may from time to time require of them ; and the Comptroller-General, or any of his assistants or employees, when duly authorised by him, shall, for the purpose of securing such information, have access to and the right to examine any books, documents, papers, or records of any such department or establishment".¹ Other countries, including India, have taken steps to emphasise the independence of control and audit, which the Great War showed to be of vital importance.

2. THE COLLECTION OF REVENUE

In the early days of society the collection of dues was not a complicated matter. As Centralised Governments developed, the revenue was farmed and apportioned. This gave rise even in the Roman Empire to grave abuse, as it does in China to-day. The Zemindars in the permanently settled tracts of Bengal to-day are the descendants of the rent-farmers of the Moghul and early British period, when rent collection was entrusted to the highest bidder. Even to-day complaints are heard of exactions in the collection of the Land Revenue by the employees of the Zemindars or landlords. The loss to the Treasury and the frequent hardship to the taxpayer are the main abuses of this system wherever it obtains. In a well-known passage in Sully's *Mémoires* on the collection of revenue it is stated of his time in France that " in these times of confusion the royal funds were the prey of the one who grabbed them first. The revenues of the king were not sufficient for the avidity of the financiers, which ordinarily grew through public suffering. I had great troubles in unravelling the mysteries of the people of this profession. I discovered all the secret sources of the collectors. There were a large number ; forgeries of pretended uncollectable debts, expenses for carriages, spices etc. ; all these were so many resources used for the profit of the clerks who absorbed a portion of the revenue. . . . The contractors (*fermiers*) and the Treasurers of France realised almost twice as much as the sum for which the contract was given to them." ² In the French Revolution the end of tax-farmers was a speedy one. A tribunal, for example, declared them individually

¹ Act 10th June 1921, C. 18, § 313, 42 Stat. 20.

² Cf. Stourm's *The Budget*, Plazinski's translation, p. 538.

and collectively guilty of malpractices and embezzlement, and, in Stourm's words, "as soon as the sentence of death was passed upon them they mounted the scaffold, twenty-eight of them, on the same day at five o'clock in the afternoon (8th May 1794). Their stewardships were thus audited."¹ To-day most countries have an organised and efficient staff of tax collectors. The collection of direct taxes requires a dual mechanism, one for determining the tax due and the other for collecting the tax. In the interests of economy these two functions are discharged by one set of officials in most cases. In France there is the controller, two or three per district who go out for at least nine months in each year touring through the parishes which comprise the district. As one writer has said, these controllers, by their uniforms, by their associations, by the examination and diplomas required for their appointment, constitute a big body of officials. Similarly in India there are the collectors, the executive heads of districts whose function is to supervise the collection of Land Revenue in addition to their work as District Magistrates. In England there are the Inspectors of Taxes, whose efficiency has been referred to in the chapters on income tax. All these officers have to be paid adequate salaries in order to enable them to be efficient and free from all temptation. In the case of indirect taxes the administration has to deal with a smaller number of persons, and the work is comparatively easy. A large staff, however, is required for preventing traffic by smuggling or illicit distillation, and it is false economy to cut down the excise preventive staff when it interferes with their efficiency. It means a loss of revenue to the State.

3. THE TREASURY

When the taxes are collected how should they be paid to the State? The older practice was for the funds to be transferred in cash to certain offices or Treasuries up and down the country-side. In some countries, as in India to-day, this practice still obtains. India has 300 district Treasuries and 1200 sub-Treasuries, but the Imperial Bank of India conducts the Treasury business wherever it has a local head office or branch office. In Great Britain the public receipts and payments are centralised in the Bank of

¹ Cf. Stourm's *The Budget*, Plazinski's translation, p. 540.

England in London, and there are no outlying State Treasuries. The Bank of France conducts a considerable amount of work on behalf of Government, although, it will be remembered, in 1806 Napoleon refused to entrust to the Bank of France the functions of cashier of the State. "I want the State to be able to shift the Army without the Bank's knowing, and the Bank would know if it were familiar with my needs for money." The United States, like India, owing to the large extent of territory, has, in a modified way, the Treasury system, but depends mainly on the country's banking system. The Federal Reserve system has done much in regard to the management of public funds by developing banking on systematic lines. Resource operations or distributing the cash balances of a country between the various centres so that each shall at all times have sufficient funds to meet its fluctuating requirements constitute a difficult problem. To move funds from one place to another is a costly matter. In India a Paper Currency Reserve is distributed through the country in the various Treasuries by means of currency chests, and these serve as a useful means for transferring funds. The deposit of notes in a currency chest decreases the amount of notes in circulation, and the deposit of rupees in a currency chest increases the amount of coin in the Paper Currency Reserve. A deposit of coin or notes in a currency chest thus enables Government to issue notes elsewhere up to the amount of the deposit. If a transfer of funds is necessary from Treasury X to Treasury Y, this can therefore be effected without actually remitting coin or notes by transferring money from the Treasury balance to the currency chest at X and transferring the same amount from the currency chest to the Treasury balance at Y. Council Bills and telegraphic transfers are also utilised for the transfer of funds by private individuals.

4. THE METHOD OF SPENDING

Votes of credit for expenditure are necessary in some periods of the year in order to place departments of Government in sufficient funds for carrying on their ordinary duties. In France votes of credit are passed for each month before the Budget is finally passed, and these are called "provisional twelfths". Votes of credit are more extensively used during war time than at any other time. The Provisional Collection of Taxes Act of

1913 in Great Britain and of 1918 in India make it possible for taxes to be collected before the actual passing of the Finance Act. Retrospective effect can be given to Finance Bills in India for a period of one month. Special care is taken that expenditure incurred is authorised expenditure. Thus in Great Britain expenditure conforms closely to the Appropriation Act. The requisition is made by the Treasury to the Comptroller-General, and is supported, as we have seen, by an Act of Parliament. Grants of credit are made by the Comptroller-General, whose duty it is to verify that the amount required has been included in the amount sanctioned by Parliament under the Appropriation Act. A Treasury order then issues to the Bank to transfer the specified sum to the account of the Paymaster-General. In other countries the procedure is similar, although differing in points of detail.

In India the work of communicating grants to the disbursing and controlling officers is taken up immediately after the passing of the Budget by the legislature. Expenditure against appropriations is watched by dividing grants into primary units of appropriations, *e.g.* the pay of officers, establishment, contingencies, allowances and honoraria, supplies and services, grants-in-aid, contributions and donations, works, assignments, and compensations, establishment charges payable to other Government departments, refunds, reserve, suspense and expenditure in England. These appropriations are sometimes further subdivided for purposes of financial control. Appropriation is in force only until the close of the financial year, and this requires considerable control to avoid extravagance and a rush of expenditure in March. Before any expenditure can be incurred both administrative sanction and Budget provision are required. Neither the one nor the other is by itself sufficient. Engineering works require in addition to administrative sanction and Budget provision what is known as technical sanction or the approval of plans and estimates. The watching of the actual expenditure rests with the head of the department. The Accountant-General in each province communicates with the Finance Department if the rate of expenditure proceeds at a rate which is likely to exceed the Budget amount. A review of the estimates for the current year takes place four times annually, once after three months, the second after six months, the third and fourth being the Budget forecasts mentioned in a previous chapter. Before

payment is made of Government moneys the same vigilance has to be exercised by an officer as he would do in respect of expenditure of his own private money. The paying agent has to see that the authorised amounts have not been exceeded, that the documents for each claim are genuine, and that a receipt in due form is given.

5. ACCOUNTS

In recent years States have given considerable attention to the science of accountancy. Double-entry book-keeping and costing are two examples of what should be followed where possible. The advantage of double entry is that each entry is controlled by a similar entry elsewhere, and it will be necessary to commit two errors of the same magnitude in order to avoid showing the error in the accounts. Costing applies particularly to the Public Works Department—a department which has in most countries a reputation for extravagance. It is also essential to see that revenue and capital accounts are kept separate, in order that the two do not overlap. The accounts should be classified in such detail as to secure uniformity of accounting, to render possible a comparison between figures for different periods and localities, to facilitate the preparation of Budget estimates, and above all to ensure effective financial control, combined with economy, by means of a periodical review of receipts and expenditure entrusted to disbursing officers. In India the method of classification and compilation of public accounts consists of four stages: (1) the monthly compilation by the district treasuries and certain departmental officers, (2) the monthly compilation by the Accountants-General, (3) the monthly compilation for the whole of India by the Controller of the Currency for certain heads of account, and (4) the annual compilation of a consolidated account by the Auditor-General for the whole of India. The accounts are also in considerable detail in order to show the principles enunciated above. Thus there are 13 groups under revenue, 17 under expenditure, and 10 on each side under different heads. The groups include (a) principal heads of revenue, (b) railways, (c) irrigation, etc. These groups are subdivided into major heads, of which there are about 42 under revenue, 59 under expenditure, and 60 on each side under debt and remittance. Major heads are subdivided

further into minor heads, of which there are 400 in regard to revenue, nearly 500 in regard to expenditure, and several hundreds under debt and remittance. These are subdivided into detailed heads which run into thousands. The Reforms under the Constitution of 1919 have necessitated the classification of revenue and expenditure into central and provincial, non-votable and votable, and reserved subjects and transferred.

6. CONTROL

A reference has been made above to control, which was divided into administrative, judicial, and legislative.

Administrative control is exercised not merely by heads or subordinate officers but by the department of the Government controlling these officers. The Treasury or the Finance Department also controls and raises objections to proposed expenditure, and draws attention to facts and considerations to which sufficient weight has not been attached. Its consent should be obtained before any expenditure involving any new principle is sanctioned. No expenditure in excess of the estimates should be incurred without previous consultation with the Finance Department. Any proposal involving an abandonment of revenue of which credit has been taken in the Budget, or involving expenditure for which no provision has been made in the Budget, should be submitted for the consideration of Government or the legislature without the previous reference to the Treasury or the Finance Department. The watchdog of finance must be regarded with awe by the other departments of the administration. Judicial control is exercised chiefly in France. It was founded by Napoleon in 1807, and "it is", as one writer points out, "a veritable court of justice, which has for its object to verify the actions of the accountants, to discharge them from their responsibility in case their management is regular and correct, or to place to their charge any balances they may be owing through fraud, imprudence, or infraction of rules; in such cases the Court of Accounts pronounces judgment".¹ It does not encroach on the administration. For example, accountants make payments on orders received from superior

¹ Fisk, *French Public Finance*, p. 224 (Bankers' Trust Company, New York, 1922).

authority. The Court of Accounts does not dispute these payments. The *Cour des Comptes* is not a branch of the administration, but an independent judicial body ; it bases its criticisms on documentary evidence only. It works on closed accounts, and exercises no preventive control, and it bases an opinion on the action of Ministers only after examining the individual accounts of accountable officers.

Legislative control is that exercised by the legislature usually through committees, as in the Committee of Public Accounts of the British House of Commons appointed annually since 1861, at the beginning of its session for the examination of accounts. The number of members of the Committee is usually 15. The Committee examines the preliminary grant for each financial year, including supplementary grants, with a view to seeing whether the grants Parliament passed have been properly applied. It also scrutinises any excess overgrants or bad spending on the part of the Executive. Its researches are published and are an effective means by which the House of Commons controls Government expenditure. The findings of the Public Accounts Committee are based on the Audit and Appropriation Reports submitted by the Comptroller and Auditor-General. In Section I. of the British Exchequer and Audit Departments Act, 1921, it is provided that the Comptroller and Auditor-General shall report to the House of Commons any important change in the extent or character of any examination made by him. This includes revenue and stores accounts in addition to accounts of expenditure, which alone used to be scrutinised previously. A day is sometimes allowed in the House of Commons for a discussion of the Report of the Public Accounts Committee, and in this way the House of Commons satisfies itself that its appropriations are properly utilised. There is in the legislature of France a Commission for the verification of the accounts submitted by the Ministers. It is composed of members chosen from the Senate, the Chamber of Deputies, and the Court of Accounts. The Commission examines the accounts of the executive officials who authorise expenditure, the Ministers' annual accounts, and the work already completed by the Court of Accounts, a judicial body. Its control over expenditure is undoubtedly far-reaching. In India legislative control is exercised through the Committee on Public Accounts appointed

by rules made under the Government of India Act, 1919. It is customary in all provinces and in the Central Legislature for the Finance Committee¹ to examine expenditure before it is submitted to the vote of the legislature. The duty of the Public Accounts Committees is to see that the money voted by the legislature has been spent within the scope of the demand, and that every re-appropriation from one grant to another or within the same grant, and all expenditure which the Finance Committee requests to be brought to the notice of the legislature, are duly brought forward. The Committee also summons and examines officers responsible for the appropriations in question. The Auditor-General submits two reports, (1) the audit report, and (2) the appropriation report. The first deals with the audit and the second with appropriation. In March of the succeeding financial year the Auditor-General submits an annual appropriation report, which forms the basis of the discussion of the Committee on Public Accounts. The Committee on Public Accounts submits the report to the legislature, which can make recommendations. The Executive ordinarily gives effect to these after due consideration. Experience has shown that the most common irregularities are the withdrawal of money before the completion of works or in advance of requirements, a rush of expenditure in March to avoid lapse of grants, the postponement of inevitable payment, unusual expenditure, losses resulting from disregarding rules, double payments, or the manipulation of accounts with fraudulent intent and embezzlement.

7. AUDIT

Audit from the Government point of view differs from that of commercial audit, since the objects of the two are somewhat different. The auditor is an independent person, and cannot be removed easily from his post. Under the American Budget and Accounting Act, 1921, the term and removal of officers is specified as follows: "Except as hereinafter provided in this section, the Comptroller-General and the Assistant Comptroller-General shall hold office for fifteen years. The Comptroller-General or the

¹ The Finance Committee has no statutory basis. It is appointed mainly in pursuance of the recommendation made in paragraphs 235 and 285 of the Montagu-Chelmsford Report.

Assistant Comptroller-General may be removed at any time by joint resolution of Congress after notice and hearing when, in the judgment of Congress, the Comptroller-General or Assistant Comptroller-General has become permanently incapacitated, or has been inefficient, or guilty of neglect of duty, or of malfeasance in office, or of any felony or conduct involving moral turpitude, and for no other cause and in no other manner except by impeachment. Any Comptroller-General or Assistant Comptroller-General removed in the manner herein provided shall be ineligible for re-appointment to that office. When a Comptroller-General or Assistant Comptroller-General attains the age of seventy years, he shall be retired from his office.”¹ The object of audit is the detection of fraud, the detection of technical errors (*e.g.* the failure to sign a statement in the proper form) and also errors of principle (*e.g.* the incurring of expenditure without proper sanction and adequate appropriation). Of these the detection of fraud and errors of principle are the most important. The spirit of audit and its interpretation should be liberal. The interests of the taxpayer should be protected, revenue increased, expenditure economised, and disbursing officers assisted. This is more useful than showing every trifling infringement of rules and regulations which often results in unnecessarily protracted correspondence. If two rules are conflicting the more fundamental of them should be followed. The ideal auditor should, in fact, be one who asks every question that may be expected from an intelligent taxpayer bent on getting the best value for his money. In many countries there is in addition to audit of expenditure a careful audit of receipts. In Great Britain under section 2 of the Exchequer and Audit Departments Act, 1921, the audit of receipts is conducted by the Comptroller-General and the result reported to the House of Commons. Section 4 of the same Act authorises him to examine the stocks and stores account and report on them to the legislature. In India, however, the check on receipts is exercised mostly by the revenue-collecting authorities. The Auditor-General arranges for this class of audit only in cases in which it is so required by the Government of India. The Civil Audit officers perform this duty in a small number of cases only. The audit of railway earnings, however, is an exception to this rule. It is essential to remember that a great deal depends on the

¹ Act 10th June 1921, c. 18, § 303, 42 Stat. 20.

initial examination of vouchers, and of receipts for expenditure. On this depends the utility of further checks and re-checks. It is important for every audit officer to see that in auditing accounts there are (1) sanction by the competent administrative authority, and (2) appropriation of necessary funds granted by the legislature. In the audit of stores it is advisable to see that the accounts of receipts of stores and of issues and balances are correctly maintained, and that steps are taken to dispose of unserviceable and surplus stores. The rates paid for stores should agree with those mentioned in the contract or agreement entered into with sellers, and there should be proper sanction for their purchase. In public works audit muster rolls or the list of labourers of those employed daily on works have also to be carefully scrutinised to prevent fraud, which sometimes occurs in the most surprising of ways. In audit there is not infrequently the danger of the machine becoming master of the man, not the man the master of the machine. This should sedulously be avoided, and dilatoriness must never be regarded as an equal virtue with despatch.

This last remark may be said to apply generally to financial administration which has been built up after centuries of scientific elaboration. It is a machine worked by perhaps the most upright and highly specialised engineers in the world. There is sometimes a danger of the many wheels in the machine retarding each other's progress : so many written rules to be observed that the spirit is sacrificed to the letter. Financial administration must needs be cautious and reasoned, but there is no ground why it should not be also firm and prompt.

TABLE VI

INCREASE IN EXPENDITURE

INDEX NUMBERS OF GROSS EXPENDITURE OF THE GOVERNMENT OF INDIA
(CENTRAL, PROVINCIAL, AND LOCAL)

(Figures for 1871-72 100.)

Heads of Expenditure.	50 Years ago, 1871-72.	40 Years ago, 1881-82.	30 Years ago, 1891-92.	20 Years ago, 1901-2.	10 Years ago, 1911-12.	Pre-War Year, 1913-14.	1921 to 1922.
<i>A. Primary Expenditure.</i>							
I. Defence	100	125	145	159	193	196	479
II. Law and order --							
Law and justice	100	111	128	151	197	210	268
Police	100	115	174	182	311	329	578
Total	100	113	148	164	246	261	402
III. Civil administration--							
General administration	100	84	98	106	216	163	604
Political	100	208	243	327	460	551	715
Cost of collection--							
Direct	100	125	159	174	232	244	252
Indirect	100	125	120	153	129	150	261
Total	100	118	133	156	202	204	366
IV. Debt services --							
Productive	100	109	336	478	683	749	1099
Unproductive	100	81	72	49	51	38	285
Total	100	88	131	115	193	197	468
<i>B. Secondary Expenditure.</i>							
V. Social--							
Education	100	170	225	169	479	752	1421
Medical and sanitation	100	137	177	183	346	401	945
Famine . . . . .	..	100 ¹	81	85	96	96	85
Ecclesiastical	100	103	102	107	118	121	193
Total	100	270	289	269	499	655	1190
VI. Public undertakings--							
Railways . . . . .	..	100 ¹	150	76	78	79	86
Irrigation . . . . .	..	100 ¹	139	161	226	253	472
Other public works	100	120	147	90	194	249	299
Posts and telegraphs	100	..	291	420	443	910	910
Mint	100	151	204	901	208	237	1281
Stationery, etc.	100	509	519	690	865	943	1858
Forests	100	158	238	208	483	497	1189
Ports and pilotage . . . . .	..	..	..	100 ²	141	158	267
Scientific and miscellaneous departments . . . . .	..	100 ¹	104	127	255	268	670
Total	100	347	480	352	486	543	845
VII. Miscellaneous--							
Refunds, etc.	100	73	89	94	116	118	224
Miscellaneous	100	167	129	214	240	203	278
Total	100	131	114	168	193	170	257
Grand total	100	148	182	184	243	256	492

¹ In these cases figures for 1881-82 are taken as 100.² In this case figure for 1901-2 is taken as 100.

TABLE
PROVINCIAL OR STATE
GROSS EXPENDITURE OF THE PROVINCIAL
(In Thousands of Rupees)

Heads of Expenditure.	1891-92.	1901-2.	1911-12.	1913-14.
<i>A. Primary Expenditure.</i>				
I. Defence . . . . .	..	..	..	..
II. Law and order—				
Law and justice	50,30	55,50	66,66	69,14
Police	53,26	64,05	1,01,50	1,00,58
Total	1,03,56	1,19,55	1,68,16	1,69,72
	26-0	23-6	23-7	21-4
III. Civil administration—				
General administration	13,62	15,34	27,55	19,37
Political	3,25	4,21	4,32	4,36
Cost of collection—				
Direct taxes	64,09	65,67	83,31	85,44
Indirect taxes	1,04	4,19	15,51	15,78
Total	85,00	89,41	1,30,69	1,24,95
	21-3	17-6	18-5	16-8
IV. Debt services—				
Productive purposes . . . . .	..	..	9,62	10,74
Unproductive purposes	1,79	5,54	6,37	8,72
Total	1,79	5,54	15,99	19,46
	0-5	1-4	2-3	2-5
Total primary expenditure	1,90,35	2,14,50	3,14,84	3,14,13
	47-8	42-3	44-5	39-7
<i>B. Secondary Expenditure.</i>				
V. Social—				
Education	16,36	18,52	48,73	72,76
Medical and sanitation	13,28	19,60	24,36	27,21
Famine relief, etc.	2	..	13,70	13,70
Ecclesiastical . . . . .	..	..	..	..
Total	29,66	38,12	86,79	1,13,67
	7-4	7-5	12-2	14-3
VI. Government or public under- takings—				
Railways	11,71	..	8	..
Irrigation	38	16	22,92	25,98
Other public works	39,82	34,61	1,35,42	1,19,04
Posts and telegraphs	1,11	1,03	..	..
Mint . . . . .	..	..	..	..
Stationery and printing	5,84	10,83	13,62	14,98
Forests	9,64	8,60	26,64	25,90
Ports and pilotage	43	47	71	1,81
Scientific and miscellaneous	1,87	2,01	10,84	12,04
Total	70,80	57,74	2,10,23	1,99,75
	17-8	11-4	29-7	25-2
VII. Miscellaneous—				
Refunds, drawbacks, etc	93,74	1,00,28	1,01,17	1,04,94
Miscellaneous	13,83	96,57	4,96	59,82
Total	1,07,57	1,96,85	96,21	1,64,76
	27-0	38-8	13-6	20-8
Total secondary expenditure	2,08,03	2,92,71	3,93,23	4,78,18
	52-2	57-7	55-5	60-3
Grand total	3,98,38	5,07,21	7,08,07	7,92,31
	100-0	100-0	100-0	100-0

VII

EXPENDITURE

GOVERNMENT OF BOMBAY

and in Percentages.)

1914-15.	1915-16.	1916-17.	1918-19.	1919-20.	1920-21.	1921-22.
..
70,60	70,61	69,50	81,70	93,79	1,05,60	1,02,39
1,04,25	1,05,80	1,06,16	1,19,34	1,50,12	1,76,22	1,92,01
1,74,85	1,76,41	1,75,66	2,01,04	2,43,91	2,81,82	2,94,40
23.1	22.7	21.5	20.0	21.7	24.3	19.6
21,15	20,50	20,50	22,61	26,94	36,87	1,22,63
5,16	5,03	5,02	5,70	7,30	8,19	..
89,87	87,45	83,48	1,03,38	1,16,89	1,38,54	1,66,17
16,33	16,39	16,25	19,55	23,30	45,98	39,00
1,32,51	1,29,37	1,25,25	1,51,24	1,74,43	2,29,58	3,27,80
17.5	16.7	15.3	15.1	15.5	19.8	21.8
11,92	12,65	12,57	14,04	15,20	15,59	12,78
8,14	7,40	6,48	7,08	11,79	20,67	84,78
20,06	20,05	19,05	21,12	26,99	36,26	97,56
2.7	2.6	2.3	2.1	2.4	3.2	6.5
3,27,42	3,25,83	3,19,96	3,73,40	4,45,33	5,47,66	7,19,76
43.3	42.0	39.1	37.2	39.6	47.3	47.9
83,03	75,30	76,02	1,07,65	1,29,52	1,43,67	1,72,43
25,00	23,86	23,79	33,48	45,36	57,71	75,15
13,70	13,70	3,79	6,80	10,01	3,67	27,27
1,21,73	1,12,86	1,03,60	1,47,93	1,84,89	2,05,05	2,74,85
16.1	14.5	12.7	14.7	16.4	17.7	18.3
23,48	23,34	20,28	25,10	30,42	35,94	1,11,88
1,13,51	85,70	75,13	1,18,06	1,75,94	2,07,55	1,88,09
..
15,34	12,43	14,72	17,80	19,80	23,85	22,69
24,88	26,42	25,65	78,72	59,19	53,05	50,79
1,74	1,86	1,24	1,28	1,32	1,63	1,50
13,96	13,58	14,25	23,12	27,62	30,58	43,55
1,92,91	1,63,33	1,51,27	2,64,08	3,14,29	3,52,60	4,18,50
25.4	21.1	18.5	26.3	27.9	30.4	27.9
1,06,64	1,08,17	1,04,52	1,09,79	1,24,22	1,35,93	..
7,15	65,41	1,38,12	1,08,60	56,14	82,97	88,81
1,13,79	1,73,58	2,42,64	2,18,39	1,80,36	52,96	88,81
15.2	22.4	29.7	21.8	16.1	4.6	5.9
4,28,43	4,49,77	4,97,51	6,30,40	6,79,54	6,10,61	7,82,16
56.7	58.0	60.9	62.8	60.4	52.7	52.1
7,55,85	7,75,60	8,17,47	10,03,80	11,24,87	11,58,27	15,01,92
100.0	100.0	100.0	100.0	100.0	100.0	100.0

TABLE

PROVINCIAL OR STATE

GROSS EXPENDITURE OF THE PROVINCIAL

(In Thousands of Rupees)

Heads of Expenditure.	1891-92.	1901-2.	1911-12.	1913-14.
<i>A. Primary.</i>				
I. Defence . . . . .	..	..	..	..
II. Law and order—				
Law and justice	52,81	61,49	76,26	84,67
Police	41,62	47,81	84,59	92,48
Total	94,43	1,09,30	1,60,85	1,77,15
	33.1	29.1	22.9	23.4
III. Civil administration—				
General administration .	10,07	10,28	18,20	14,27
Political	76	77	1,03	89
Cost of collection—				
Direct taxes	48,78	53,03	1,29,56	1,47,14
Indirect taxes	8,65	16,13	23,65	24,02
Total	68,26	80,21	1,72,44	1,86,32
	23.9	21.3	21.6	24.6
IV. Debt services—				
Productive . . . . .	..	..	14,23	14,36
Unproductive	69	1,80	3,16	3,22
Total	69	1,80	17,39	17,58
	0.2	0.5	2.5	2.3
Total primary expenditure .	1,63,38	1,91,31	3,50,68	3,81,05
	57.2	50.9	50.0	50.3
<i>B. Secondary.</i>				
V. Social—				
Education	14,54	18,27	45,67	79,51
Medical and sanitation .	11,57	13,02	18,27	24,86
Famine relief	1,57	49	2,50	2,50
Ecclesiastical . . . . .	..	..	..	..
Total	27,68	31,78	66,44	1,06,87
	9.7	8.5	9.5	14.1
VI. Government undertakings—				
Railways	4,63	..	..	..
Irrigation	39,99	35,54	46,82	52,11
Other public works . . .	31,38	29,79	1,10,13	1,64,90
Posts and telegraphs . .	90	1,06	..	..
Mint . . . . .	..	..	..	..
Stationery and printing .	7,53	9,28	15,55	15,88
Forests	13,13	8,55	34,15	29,36
Ports and pilotage . . .	1,50	13	21	46
Scientific and miscellane-				
ous departments . . .	3,51	6,89	13,36	17,78
Total	1,02,57	91,24	2,20,22	2,80,49
	35.9	24.3	31.4	37.0
VII. Miscellaneous—				
Refunds, drawbacks, etc.	1,30	1,33	4,88	5,55
Miscellaneous	-9,48	59,90	59,10	-16,52
Total	8,18	61,23	63,98	-10,97
	-2.8	16.3	9.1	-1.4
Total secondary expenditure .	1,22,07	1,84,25	3,50,64	3,76,39
	42.8	40.1	50.0	49.7
Grand total	2,85,45	3,75,56	7,01,32	7,57,44
	100.0	100.0	100.0	100.0

VIII

EXPENDITURE

GOVERNMENT OF MADRAS

(and in Percentages.)

1914-15.	1915-16.	1916-17.	1918-19.	1919-20.	1920-21.	1921-22.
..
98,07	99,75	1,01,10	1,11,14	1,26,95	1,48,04	1,24,15
1,09,31	1,10,10	1,14,75	1,21,15	1,41,70	1,77,00	2,00,40
2,07,38	2,09,85	2,15,85	2,32,29	2,68,65	3,25,04	3,24,55
27.4	27.3	27.2	26.5	27.5	33.0	25.5
15,23	15,51	15,15	16,71	19,59	24,46	1,35,11
85	86	92	92	1,01	1,08	..
1,25,68	1,23,85	1,23,09	1,30,34	1,36,51	1,81,90	1,30,38
24,07	23,89	24,43	28,05	30,97	35,84	59,10
1,65,83	1,64,11	1,63,59	1,76,02	1,88,08	2,43,28	3,24,59
21.9	21.4	20.6	20.1	19.2	24.7	25.5
14,99	15,07	14,48	15,60	10,70	15,48	38,21
3,28	3,31	3,28	3,75	4,18	4,73	-3,71
18,27	18,38	17,76	19,35	14,88	20,21	34,50
2.4	2.4	2.2	2.2	1.5	2.0	2.7
3,91,48	3,92,34	3,97,20	4,27,66	4,71,61	5,88,53	6,83,64
51.7	51.1	50.0	48.9	48.2	59.7	53.7
78,31	76,97	83,17	1,10,21	1,22,38	1,33,04	1,43,24
25,18	50,28	35,04	42,53	57,43	67,93	85,32
2,50	2,50	2,50	23	9,72	11	10,67
1,05,99	1,29,75	1,20,71	1,52,97	1,89,53	2,01,08	2,39,23
14.0	16.9	15.2	17.5	19.4	20.4	18.8
56,68	49,35	45,55	54,49	56,24	52,81	40,39
1,63,05	87,01	79,76	1,03,22	1,11,63	1,13,50	1,21,86
..
14,80	14,85	12,92	13,32	19,55	24,30	24,71
28,61	29,27	28,43	31,83	36,93	45,30	52,29
37	47	37	44	37	52	54
18,51	21,49	24,29	33,29	39,17	44,30	56,86
2,82,02	2,02,44	1,91,32	2,36,59	2,63,89	2,80,73	2,96,65
37.2	26.4	24.1	27.0	27.0	28.4	23.3
5,27	5,50	5,66	7,18	11,90	18,68	..
-27,41	37,67	79,88	50,25	40,58	-1,02,62	-54,07
-22,14	43,17	85,54	57,43	52,48	-83,94	-54,07
-2.9	5.6	10.7	6.6	5.4	-8.5	4.2
3,65,87	3,75,36	3,97,57	4,46,99	5,05,90	3,97,87	5,89,95
48.3	48.9	50.0	51.1	51.8	40.3	46.3
7,57,35	7,67,70	7,94,77	8,74,65	9,77,51	9,86,40	12,73,59
100.0	100.0	100.0	100.0	100.0	100.0	100.0

TABLE

PROVINCIAL OR STATE

GROSS EXPENDITURE OF THE PROVINCIAL

(In Thousands of Rupees)

Heads of Expenditure.	1891-92.	1901-2.	1911-12.	1913-14.
<i>A. Primary.</i>				
I. Defence . . . . .	..	..	..	..
II. Law and order—				
Law and justice	1,05,05	1,23,95	1,16,63	1,23,00
Police	59,62	61,95	86,71	94,71
Total	1,64,67	1,85,90	2,03,34	2,17,71
	28.9	38.4	30.7	35.0
III. Civil administration—				
General administration .	16,16	18,32	29,18	24,30
Political	35	18	58	33
Cost of collection —				
Direct	46,39	42,69	42,71	35,18
Indirect	14,17	22,75	17,10	21,14
Total	77,07	83,94	89,57	80,95
	13.5	17.4	13.5	13.0
IV. Debt services—				
Productive purposes . .	61,02	24,54	10,51	1,70
Unproductive purposes .	1,01	2,10	5,22	4,40
Total	62,03	26,64	15,73	6,10
	10.9	5.5	2.4	1.0
Total primary expenditure .	3,03,77	2,96,48	3,08,64	3,04,76
	53.3	61.3	46.6	49.0
<i>B. Secondary.</i>				
V. Social—				
Education	25,52	29,41	58,54	81,13
Medical and sanitation .	15,67	20,59	25,07	28,50
Famine relief . . . . .	..	4	2,60	60
Ecclesiastical . . . . .	..	..	..	..
Total	41,19	50,04	86,21	1,10,23
	7.2	10.4	13.0	17.7
VI. Government undertakings—				
Railways	1,05,73	..	..	1
Irrigation	29,29	24,24	16,49	11,12
Other public works . . .	40,25	44,92	88,21	1,02,19
Posts and telegraphs . .	5	3	..	..
Mint . . . . .	..	..	..	..
Stationery and printing .	13,36	12,94	10,90	14,85
Forests	2,10	3,28	7,06	6,40
Ports and pilotage . . .	9,42	10,12	12,56	14,28
Scientific departments .	3,13	5,22	13,53	14,26
Total	2,03,33	1,01,05	1,48,75	1,63,11
	35.7	20.9	22.5	26.3
VII. Miscellaneous—				
Refunds, drawbacks, etc.	3,20	3,54	2,38	1,63
Miscellaneous	17,75	32,37	1,16,10	41,68
Total	20,95	35,91	1,18,48	43,31
	3.7	7.4	17.9	7.0
Total secondary expenditure .	2,65,47	1,87,00	3,53,44	3,16,65
	46.6	38.7	53.4	51.0
Grand total	5,69,24	4,83,48	6,62,08	6,21,41
	100.0	100.0	100.0	100.0

IX

EXPENDITURE

GOVERNMENT OF BENGAL

and in Percentages.)

1914-15.	1915-16.	1916-17.	1918-19.	1919-20.	1920-21.	1921-22.
..
1,27,29	1,28,18	1,27,17	1,41,83	1,45,32	1,70,32	1,42,29
1,03,73	1,09,04	1,16,57	1,32,25	1,43,95	1,65,52	1,92,82
2,31,02	2,37,22	2,43,74	2,74,08	2,89,27	3,35,84	3,35,11
37.1	37.4	36.8	37.1	34.3	38.9	32.0
24,18	23,89	24,82	25,93	27,93	32,00	1,12,67
18	23	89	2,87	37	67	..
34,67	35,53	35,74	39,19	39,28	55,04	37,30
21,46	21,93	23,87	25,28	28,41	31,05	38,95
80,49	81,58	85,32	93,27	95,99	1,18,76	1,88,92
12.9	12.9	12.9	12.5	11.4	13.8	18.0
1,76	1,74	1,65	1,75	1,71	1,90	39,54
4,40	4,77	5,02	4,56	5,09	5,28	-8,36
6,16	6,51	6,67	6,31	6,80	7,18	31,18
1.0	1.0	1.0	0.9	0.8	0.8	3.0
3,17,67	3,25,31	3,35,73	3,73,66	3,92,06	4,61,78	5,55,21
51.0	51.3	50.7	50.6	46.5	53.5	53.0
92,07	84,83	76,87	86,12	98,23	1,08,40	1,20,64
30,15	26,99	27,30	36,72	44,26	50,78	76,09
60	60	20,07	9	3,16	3	2,00
1,22,82	1,12,42	1,06,24	1,22,93	1,45,65	1,59,21	1,98,73
19.8	17.7	16.0	16.6	17.3	18.4	19.0
15,09	12,47	10,95	14,11	17,06	14,73	22,88
1,24,74	89,35	64,40	1,03,77	1,12,32	1,51,32	1,42,58
..
12,70	13,02	12,92	13,74	17,36	19,32	25,19
6,71	5,94	6,20	8,26	9,72	13,37	13,38
13,78	13,73	11,15	12,86	26,71	16,19	1,47
15,38	15,86	15,56	39,74	24,51	28,86	34,76
1,88,40	1,50,37	1,21,18	1,92,48	2,07,68	2,43,79	2,40,26
30.3	23.7	18.3	26.0	24.7	28.2	22.9
2,35	2,11	3,23	3,68	7,39	16,98	..
-9,14	44,39	95,94	46,26	89,38	-17,91	53,72
-6,79	46,50	99,17	49,94	96,77	- 93	53,72
-1.1	7.3	15.0	6.8	11.5	- 0.1	5.1
3,04,43	3,29,09	3,26,59	3,65,35	4,50,10	4,02,07	4,92,71
49.0	48.7	49.3	49.4	53.5	46.5	47.0
6,22,10	6,34,60	6,62,32	7,39,01	8,42,16	8,63,85	10,47,92
100.0	100.0	100.0	100.0	100.0	100.0	100.0

TABLE X

GROWTH OF EXPENDITURE ALLOWING FOR PRICES IN VARIOUS COUNTRIES

Per Capita TOTAL EXPENDITURE OF GOVERNMENTS ON THE PRE-WAR
PURCHASING POWER BASIS ¹(Adapted from Taxation and National Income—Bulletin No. 55 of the
National Industrial Conference Board, New York, U.S.A.)

Fiscal Year. ²	United Kingdom	United States.	France. ³	Italy.	Germany.	Japan.	India.
	£	£	£	£	£	£	£
1902-3	8.3	4.6	4.9	2.9	9.1 ⁴	1.0	0.5
1912-13	8.2	6.8	6.3	4.5	13.8	1.8	0.4
1913-14	8.2	7.1	6.7	4.4	14.1	1.7	0.4
1914-15	15.7	7.5	11.8	6.5	17.3	1.9	0.4
1915-16	28.7	6.5	17.0	7.7	20.9	1.7	0.4
1916-17	30.6	6.8	20.5	8.8	21.3	1.5	0.4
1917-18	29.8	12.7	17.8	7.9	29.7	1.3	0.5
1918-19	26.8	18.0	17.3	9.5	23.3	1.3	0.5
1919-20	15.9	7.9	15.8	5.2	23.9	1.2	0.4
1920-21	12.4	9.2	12.0 ³	5.2	11.5	1.6	0.4

¹ Because of the paucity of sufficiently comparable data, no attempt has been made to take cognisance of price changes prior to World War, i.e. internal purchasing power was considered more or less stationary, with changes deemed comparatively insignificant for the general purposes at hand. The figures for each year were divided by the index number of wholesale prices in each country in the same period in order to arrive at pounds of pre-War purchasing power.

² In the case of France the fiscal year refers to calendar year the major portion of which falls within the fiscal years of other governments, i.e. in the fiscal year 1902-3, the comparable fiscal year taken for France is the calendar year 1902.

³ In the calendar year 1921, which in this table would correspond to the fiscal year 1921-22 of other countries, *per capita* expenditures on the pre-War purchasing power basis were £15.8.

⁴ Fiscal year 1903-4.

The figures given above generally include Central, Provincial or State and local Governments as far as possible. All conversions from one currency to another have been at par of exchange.

TABLE XI
THE PERCENTAGE OF PUBLIC EXPENDITURE TO NATIONAL INCOME

Country.	Currency.	Pre-War Year.			Post-War Year.		
		National Income.	Expenditure of Governments.	Percentage of Expenditure to National Income.	National Income.	Expenditure of Governments.	Percentage of Expenditure to National Income.
The United Kingdom . . .	£ millions	2,250	197.5	8.8	3,900	788.8	20.2
India (Central and Provincial) .	Rs. crores	1,942	124	6.4	2,866	239	8.4
Canada	\$ millions	1,500	..	..	2,500	..	..
Dominion expenditure . . .	"	..	127.4	8.5	..	347.6	13.9
Provincial expenditure . . .	"	..	45.8 ¹	3.1	..	76.1 ¹	3.0
Total . . . . .	..	..	173.2	11.6	..	423.7	16.9
Australia	£ millions	258	..	..	430	..	..
Commonwealth expenditure .	"	..	21.7	8.4	..	87.9	13.5
States expenditure	"	..	45.5 ²	17.6	..	87.5 ²	20.4
Total . . . . .	..	..	67.2	26.0	..	175.4	33.9
U.S.A.	\$ millions	34,000	..	..	72,000	..	..
Federal expenditure	"	..	735	2.2	..	3,618	5.0
State expenditure	"	..	384	1.1	..	635	0.9
Total . . . . .	..	..	1,119	3.3	..	4,253	5.9
France	Fr. millions	37,500	4739	12.6	140,000	21,903 ³	15.6
Japan	Yen millions	3,184	416.9	13.1	6,145	905.4	14.7
Italy	L. millions	20,200	2127	10.5	103,000	11,457	11.1

NOTE.—Only ordinary expenditure of Central and Provincial Governments have been taken. Purely local bodies have not been included for lack of sufficient data.

¹ Excludes subsidies paid by the Dominion to the States.

² Excludes Commonwealth subsidies to States.

³ Excludes special expenditure recoverable from Germany.

TABLE XII

CLASSIFICATION OF REVENUE

GROSS REVENUE OF THE UNITED KINGDOM (IN MILLIONS OF POUNDS) CLASSIFIED

Heads of Revenue.	1901-2.	1911-12.	1913-14.	1914-15.	1915-16.	1916-17.	1917-18.	1918-19.	1919-20.	1920-21.	1921-22.	1922-23.	1923-24. ¹
A. TAX REVENUE													
I. Direct taxes—													
Income tax	34.8	41.8	47.2	60.4	128.3	205.0	239.5	291.2	359.1	394.1	398.8	329.0	330.0
Estate, etc. duties	14.2	25.4	27.4	28.4	31.0	31.2	31.7	30.3	40.9	47.7	52.2	48.0	57.0
Excess profit duty . . . . .	..	..	..	..	0.1	139.9	220.2	285.0	290.0	219.2	30.5	27.8	23.3
Corporation duties . . . . .	..	..	..	..	..	..	..	..	..	0.7	17.5	19.8	14.7
Motor duties . . . . .	..	..	..	..	..	..	..	..	..	7.1	11.1	10.6	2.8
Land and house tax	2.5	9.9	2.7	2.6	2.7	2.6	2.6	2.5	2.6	2.5	2.6	3.0	2.8
Land value duties . . . . .	..	0.5	0.7	0.4	0.4	0.5	0.7	0.7	0.7	0.7	0.1	..	..
Total direct taxes	51.5	78.6	78.0	100.5	162.5	379.2	494.7	609.7	693.3	671.3	512.8	438.2	428.6
	36.0	39.8	39.3	44.4	48.2	66.2	70.0	68.6	51.7	47.0	35.6	48.1	51.2
II. Indirect taxes—													
Excise	31.6	38.4	39.6	42.8	61.2	56.4	38.8	59.4	133.7	199.8	194.3	160.8	148.0
Customs	31.0	33.6	35.5	35.7	50.6	70.6	71.3	102.8	149.4	134.0	130.8	112.3	120.0
Stamps	7.8	9.5	10.0	7.6	7.8	7.3	8.3	12.4	32.6	26.6	19.6	18.3	21.6
Total indirect taxes	70.4	81.5	85.1	85.6	127.6	134.9	118.4	174.6	365.7	360.4	344.0	291.4	289.6
	49.2	44.0	42.9	39.1	37.9	23.5	16.7	19.6	22.8	25.3	30.6	32.0	34.8
Total tax revenue	121.9	155.1	163.1	189.4	290.1	514.1	613.1	784.3	999.0	1031.7	856.8	729.6	718.2
	85.2	83.8	82.2	83.5	86.1	89.7	86.7	88.2	74.5	72.3	76.2	80.1	86.0
B. NON-TAX REVENUE													
Miscellaneous	2.0	2.5	2.3	5.9	9.8	16.5	52.1	52.3	280.8	313.3	197.1	112.0	52.8
Posts and telegraphs and telephones	17.8	25.7	30.8	29.6	33.9	34.1	35.3	40.9	34.1	49.5	56.4	54.6	52.8
Sundry loans, Suez Canal Shares, etc.	0.9	1.3	1.6	1.3	2.4	8.1	6.0	11.7	15.0	30.8	13.8	14.0	12.6
Crown lands	6.4	0.5	0.5	0.5	0.6	0.6	0.7	0.7	0.7	0.7	0.8	0.8	0.9
Total non-tax revenue	21.1	30.0	35.2	37.3	46.7	59.3	94.1	104.7	340.6	394.3	268.1	181.4	119.1
	14.8	16.2	17.8	16.5	13.9	10.3	13.3	11.8	25.5	27.7	23.8	19.9	14.0
Grand total	143.0	165.1	198.3	226.7	336.8	573.4	707.2	889.0	1339.6	1426.0	1124.9	911.0	837.3
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

¹ Estimates, Great Britain and Northern Ireland only.

TABLE
CLASSIFICATIONREVENUE OF THE GOVERNMENT OF INDIA
(In Thousands of Rupees)

Heads of Revenue.	1861-62.	1871-72.	1881-82.	1891-92.	1901-2.	1911-12.
<i>A. Tax Revenue.</i>						
I. Direct—						
Land revenue	19,91,80	20,52,03	21,94,80	23,96,58	27,39,80	31,14,70
	45.2	41.0	29.0	26.9	28.3	25.1
Income tax	2,05,47	82,52	53,68	1,05,28	2,05,40	2,47,93
Provincial rates . . . . .	..	..	2,89,55	3,50,28	1,55,77	82,30
Tributes from States	78,27	74,40	70,09	77,60	87,53	89,25
	22,75,54	22,08,95	26,08,72	29,89,74	31,88,50	35,34,18
	51.6	44.1	34.5	33.5	32.0	28.5
II. Indirect—						
Opium	6,35,93	9,25,39	9,86,24	8,01,24	7,27,80	8,94,19
Salt	4,56,33	5,96,66	7,37,56	8,63,62	8,90,90	5,08,68
Excise	1,78,62	2,36,91	3,42,73	5,11,73	6,11,50	11,41,46
Customs	2,85,19	2,57,60	2,36,14	1,70,13	5,74,95	9,70,29
Stamps	1,69,32	2,47,62	3,38,14	4,26,22	5,16,96	7,22,27
Registration . . . . .	..	28,47	..	39,98	46,94	66,88
	17,25,39	22,64,19	26,69,28	28,12,92	33,69,05	43,03,77
	39.2	45.3	35.2	31.6	34.7	34.6
Total tax revenue	40,00,93	44,73,14	52,78,00	58,02,06	65,57,55	78,37,95
	90.8	89.4	69.7	65.1	67.6	63.1
<i>B. Non-Tax Revenue.</i>						
III. Government or public under- takings—						
Railways . . . . .	..	26,64	10,88,55	19,93,80	16,08,85	23,83,76
Irrigation . . . . .	..	47,16	1,17,95	2,27,20	3,79,69	5,97,01
Other public works	58,89	9,20	54,68	57,73	32,84	49,04
Posts and telegraphs	47,71	1,04,93	1,41,93	2,36,57	3,43,09	4,83,26
Mint	38,07	9,62	7,06	21,00	83,31	55,08
Forests	25,77	50,19	87,19	1,49,06	1,73,60	2,92,83
Stationery and printing . . . . .	..	..	5,78	8,34	9,46	14,53
Scientific and miscellaneous . . . . .	..	..	13,01	9,02	30,25	39,89
	1,70,44	2,47,74	15,46,45	27,02,72	26,61,09	39,15,40
	3.9	5.0	20.5	30.3	27.5	31.5
IV. Receipts from social services—						
Education	4,23	..	18,93	21,17	16,35	30,84
Public health . . . . .	..	..	4,03	6,31	8,28	10,03
	4,23	..	22,96	27,48	24,63	40,87
	0.1	..	0.3	0.3	0.3	0.3
V. Other sources—						
Interest	9,41	36,32	90,86	87,94	1,16,80	2,17,31
Military receipts	1,12,24	1,14,13	4,59,93	1,05,26	1,58,73	2,01,45
Exchange . . . . .	..	1,37	..	8,15	3,82	15,85
Superannuation . . . . .	..	68,27	37,81	36,15	28,06	30,22
Miscellaneous	1,07,55	70,05	1,32,49	1,48,95	1,43,23	1,66,31
Total non-tax revenue	2,29,20	2,90,14	7,21,09	3,81,45	4,51,54	6,31,15
	5.2	5.6	9.5	4.3	4.6	5.1
Grand total	44,04,80	50,11,02	75,68,50	89,14,31	96,94,81	124,25,37
	100.0	100.0	100.0	100.0	100.0	100.0

a Included in land revenue.

b Included under Miscellaneous.

XIII

OF REVENUE

(CENTRAL AND PROVINCIAL) CLASSIFIED
and in Percentages.)

1913-14.	1914-15.	1915-16.	1916-17.	1917-18.	1918-19.	1919-20.	1920-21.	1921-22.
32,08,74 25-1 2,92,54 27,03 92,53 36,20,84 28-3	31,83,23 26-2 3,05,51 5,82 91,47 35,86,03 29-5	33,04,67 26-1 3,13,52 6,28 91,37 37,15,84 29-4	33,06,19 22-5 5,65,95 4,71 91,86 39,68,71 27-0	32,41,09 19-2 9,46,22 4,29 89,65 42,81,25 25-3	31,63,49 17-1 11,63,77 4,20 89,15 44,20,61 23-9	33,91,49 17-2 23,20,78 5,35 93,29 58,10,91 29-4	31,97,48 15-5 22,19,28 6,33 91,21 55,14,30 26-8	34,87,44 17-2 25,11,53 a 87,21 60,86,18 30-0
2,43,73 5,16,80 13,34,15 11,33,73 7,97,74 77,84 41,03,99 32-1	2,35,83 5,86,62 13,28,53 9,52,08 7,62,31 72,79 39,38,16 32-3	2,87,03 5,47,14 12,94,83 8,81,08 8,15,04 77,83 39,02,95 30-8	4,74,00 7,23,94 13,82,38 12,98,88 8,66,50 81,09 48,26,79 32-8	4,61,84 8,24,92 15,24,26 16,55,49 8,59,13 79,14 54,04,78 32-0	4,93,37 6,41,70 17,33,63 18,18,10 9,02,85 85,90 56,75,55 30-7	4,55,62 5,74,79 19,25,94 22,48,33 10,91,18 1,08,55 64,04,41 32-4	3,53,41 6,76,45 20,43,65 31,89,85 10,95,68 1,12,04 74,71,08 36-2	3,07,25 6,44,20 17,30,12 35,36,31 11,12,12 1,13,86 74,43,86 36-7
77,24,83 60-4	75,24,19 61-8	76,18,79 60-2	87,95,50 59-8	96,86,03 57-3	100,96,16 54-6	122,15,32 61-8	129,85,38 63-0	135,30,04 66-7
26,43,85 7,06,97 44,80 5,39,78 50,98 3,34,48 14,01 43,11 43,77,98 34-3	23,69,87 7,02,15 43,23 5,39,55 10,42 2,97,10 14,64 46,76 40,23,72 33-1	26,96,57 7,16,86 45,61 5,68,12 15,29 3,11,16 13,37 50,64 44,17,62 34-9	31,97,07 7,73,34 46,41 6,26,19 1,03,48 3,70,62 14,41 61,51 51,93,03 35-3	36,21,26 7,59,58 48,54 6,92,50 77,61 4,09,69 14,11 80,83 57,04,12 33-8	37,44,34 8,01,98 52,15 8,01,45 2,74,02 4,68,19 18,05 79,09 62,39,27 33-7	31,96,92 8,74,93 55,49 9,20,62 2,67,99 5,36,76 19,90 95,23 59,67,84 30-2	25,01,45 8,79,65 76,19 9,62,00 73,48 5,41,43 21,40 94,32 51,49,92 25-0	15,23,00 9,40,70c 73,76 9,55,03c 4,37,42 5,83,29 22,59 1,03,79 46,39,58 22-9
37,19 12,05 49,24 0-4	39,94 12,71 52,65 0-4	44,26 13,70 57,96 0-4	44,74 17,37 62,11 0-4	48,02 19,24 67,26 0-4	45,65 21,71 67,36 0-4	48,60 24,18 72,78 0-4	54,01 34,26 88,27 0-4	51,91 28,10 80,01 0-4
2,02,82 2,05,45 17,96 31,02 1,71,78 6,29,03 4-9	1,53,50 2,06,21 26 31,99 1,81,14 5,73,10 4-7	1,64,46 1,86,26 11,14 32,08 1,73,78 5,67,67 4-5	1,70,48 2,36,39 16,71 32,98 2,00,37 6,56,93 4-5	3,25,52 2,58,07 4,71,78 31,90 3,54,68 14,41,95 8-5	5,74,41 3,52,50 7,25,16 32,57 4,01,25 20,85,89 11-3	6,58,00 4,05,24 b 34,39 3,95,03 14,92,66 7-6	3,57,60 6,47,87 b 35,53 13,51,16 23,92,16 11-6	2,18,90 8,06,94 b 57,91 9,42,87 20,26,62 10-0
127,81,08 100-0	121,73,60 100-0	126,62,04 100-0	147,07,57 100-0	168,99,36 100-0	184,88,68 100-0	197,48,60 100-0	206,15,73 100-0	202,76,25 100-0

c The working expenses have been included to get the figures in a line with the previous year's figures.

TABLE XIV
CLASSIFICATION OF THE REVENUE OF LOCAL BODIES—INDIA
STATEMENT SHOWING THE ORDINARY REVENUE OF MUNICIPALITIES AND DISTRICT AND LOCAL BOARDS IN INDIA
(In Thousands of Rupees.)

	1891-92.	1901-2.	1911-12.	1913-14.	1914-15.	1915-16.	1916-17.	1917-18.	1918-19.	1919-20.	1920-21.
Municipal rates and taxes . .	2,35.00	3,52.79	5,05.70	5,46.65	5,44.12	5,80.36	6,11.52	6,41.23	6,97.42	7,41.52	8,01.19
Realisation under special Acts . .	..	5.84	8.51	10.57	10.34	10.67	11.26	11.96	12.89	13.72	14.20
Other sources of revenue . .	1,04.56	1,06.54	2,31.39	3,18.99	3,05.56	2,76.29	2,71.41	3,01.32	3,49.54	3,85.80	4,47.17
Total municipalities . .	3,39.56	4,65.17	7,45.60	8,76.21	8,60.02	8,67.32	8,94.19	9,54.51	10,59.85	11,41.04	12,62.56
Provincial rates . .	1,65.03	2,03.21	2,31.29	3,00.97	3,33.89	3,39.04	3,52.96	3,53.57	3,55.55	3,75.27	3,82.24
Civil works . .	23.80	40.04	1,32.39	2,07.76	1,87.34	1,42.46	1,25.40	1,38.25	1,70.10	1,72.35	1,69.40
Other sources of revenue . .	1,06.44	1,12.07	1,85.90	2,75.06	2,54.89	2,68.49	3,09.52	3,32.60	4,14.35	4,92.69	4,91.59
Total district and local Boards . .	2,95.27	3,55.32	5,40.58	7,83.79	7,76.12	7,50.49	7,87.88	8,24.42	9,40.00	10,40.31	10,23.23
Grand total . .	6,34.83	8,20.49	12,95.18	16,60.00	16,36.14	16,17.81	16,82.07	17,78.93	19,99.85	21,81.35	22,85.79

TABLE XV
DISTRIBUTION OF REVENUE
TABLE SHOWING THE PERCENTAGE DISTRIBUTION OF THE GROSS REVENUE OF THE GOVERNMENT OF INDIA
(Central and Provincial.)

[illegible]

TABLE

PROVINCIAL OR

GROSS REVENUE OF THE PROVINCIAL

(In Thousands of Rupees)

Heads of Revenue.	1891-92.	1901-2.	1911-12.	1913-14.
<i>A. Tax Revenue.</i>				
I. Direct—				
Land revenue	2,72,20	3,76,26	3,24,54	3,58,15
Income tax	17,03	18,53	27,07	33,46
Provincial rates . . .	..	..	..	..
Tributes from States .	..	..	..	..
Total direct tax revenue	2,89,23	3,94,79	3,51,61	3,91,51
Percentage	71.5	76.8	49.7	49.4
II. Indirect—				
Opium . . . . .	..	..	..	..
Salt	57	82	..	..
Excise	25,64	26,34	2,02,04	2,22,59
Customs	40	1,00	..	..
Stamps	40,86	47,05	38,32	44,40
Registration	2,69	2,97	7,43	8,28
Total indirect tax revenue	70,16	78,18	2,48,69	2,75,27
Percentage	17.3	15.2	35.1	34.7
Total tax revenue . .	3,59,39	4,72,97	6,00,30	6,66,88
Percentage	88.8	92.0	84.8	84.1
<i>B. Non-Tax Revenue.</i>				
III. Government or public under- takings—				
Railways . . . . .	..	..	..	..
Irrigation	17	39	18,79	22,95
Other public works . .	7,51	6,23	7,05	7,06
Posts and telegraphs .	5	..	..	..
Mint . . . . .	..	..	..	..
Forests	16,42	11,90	43,31	51,03
Stationery and printing	66	67	1,22	1,13
Scientific and miscellaneous	33	33	1,18	1,40
Total Government under- takings	25,14	19,52	71,57	83,57
Percentage	6.2	3.8	10.1	10.6
IV. Receipts from social service—				
Education	2,80	3,00	4,54	5,53
Public health	1,13	1,99	2,44	2,78
Total	3,93	4,99	6,98	8,31
Percentage	1.0	1.0	1.0	1.1
V. Others—				
Interest	2,33	3,35	11,03	14,22
Military receipts . .	..	..	..	..
Exchange . . . . .	..	..	..	..
Superannuation . . .	2,36	2,10	3,42	3,88
Miscellaneous	11,36	11,31	14,77	15,43
Total others	16,05	16,76	29,22	33,53
Percentage	4.0	3.2	4.1	4.2
Total non-tax revenue .	45,12	41,27	1,07,77	1,25,41
Percentage	11.2	8.0	15.2	15.9
Grand total	4,04,51	5,14,24	7,08,07	7,92,29
Percentage	100.0	100.0	100.0	100.0

¹ Land revenue was divided between the Central and Provincial Governments. Hence the sudden increase in the figures for 1921-22 as compared with the previous

XVI

STATE REVENUE

GOVERNMENT OF BOMBAY

and in Percentages.)

1914-15.	1915-16.	1916-17.	1918-19.	1919-20.	1920-21.	1921-22.
3,02,73 34,34 ..	3,07,26 36,66 ..	3,02,08 69,98 ..	2,61,89 1,27,07 ..	3,11,20 1,72,68 ..	2,64,36 2,14,30 ..	5,47,44 ¹ 1,14,58 ..
3,37,07 44.6	3,43,92 44.3	3,72,06 45.5	3,88,96 38.7	4,83,88 42.0	4,78,66 41.3	6,62,02 49.1
..
2,20,08	2,27,91	2,60,51	3,78,27	4,01,76	4,60,68	3,42,69
40,30 7.54	42,64 7.96	48,82 8.37	58,76 11.42	80,16 13.38	90,01 14.57	1,64,36 13.27
2,67,92 35.5	2,78,51 35.9	3,17,70 38.9	4,48,45 44.7	4,95,30 44.0	5,65,26 48.8	5,20,32 38.6
6,04,99 80.1	6,22,43 80.2	6,89,76 84.4	8,37,41 83.4	9,79,18 87.0	10,43,92 90.1	11,82,34 87.7
..
22,82 4.15	23,94 4.00	24,68 4.97	17,82 4.54	25,16 8.37	21,46 19.19	73,58 20.87
..
46,80 1.25 1.63	47,01 1.83 1.89	55,19 1.48 2.17	1,04,94 1.97 4.00	84,94 1.86 6.73	68,99 2.28 4.03	74,94 2.33 4.16
76,65 10.1	78,17 10.1	88,49 10.8	1,33,27 13.3	1,27,06 11.3	1,16,55 10.1	1,75,88 13.0
6,00 3.06 9.06 1.2	7,94 3.43 11.37 1.5	5,73 4.40 10.13 1.2	5,95 4.90 10.87 1.1	6,14 5.03 11.17 1.0	6,64 6.97 13.61 1.2	7,70 5.88 13.58 1.0
15,26 ..	12,44 ..	12,62 ..	7,45 ..	11,44 ..	14,71 ..	66,14 ..
4,55 45.32 65.13 8.6	4,53 46.67 63.64 8.2	4,59 11.82 29.04 3.6	5,77 9.01 22.23 3.2	7,35 -11.34 7.45 0.7	7,67 -38.19 -15.81 -1.4	10,48 -99.83 -23.21 -1.7
1,50,84 19.9	1,53,18 19.8	1,27,66 15.6	1,66,37 16.6	1,45,68 13.0	1,14,35 9.9	1,66,25 12.3
7,55,83 100.0	7,75,61 100.0	8,17,42 100.0	10,03,78 100.0	11,24,86 100.0	11,58,27 100.0	13,48,59 100.0

prior to 1921-22. Since 1921-22 it is an entirely provincial head of revenue.
year.

TABLE
PROVINCIAL OR
GROSS REVENUE OF THE PROVINCIAL
(In Thousands of Rupees)

Heads of Revenue.	1891-92.	1901-2.	1911-12.	1913-14.
<i>A. Tax Revenue.</i>				
I. Direct—				
Land revenue	1,49,51	2,01,09	3,11,32	3,15,78
Income tax	8,68	14,34	16,03	18,74
Provincial rates . . . .	..	..	..	..
Tributes from States . . . .	..	..	..	..
Total	1,58,19	2,15,43	3,27,35	3,34,52
	55.0	57.3	46.7	44.1
II. Indirect—				
Opium . . . .	..	..	..	..
Salt	1,18	1,03	..	..
Excise	30,35	35,17	1,50,32	1,82,56
Customs	35	94	..	..
Stamps	50,61	65,70	63,63	70,84
Registration	6,17	7,25	20,58	23,59
Total	88,66	1,10,16	2,34,53	2,76,99
	30.8	29.3	33.4	36.6
Total tax revenue	2,46,85	3,25,59	5,61,88	6,11,51
	85.8	86.6	80.1	80.7
<i>B. Non-Tax Revenue.</i>				
III. Government undertakings—				
Railways . . . .	..	..	..	..
Irrigation	1,61	1,63	55,87	57,06
Other public works	1,62	1,86	2,71	3,32
Posts and telegraphs . . . .	..	..	..	..
Mint . . . .	..	..	..	..
Forests	16,94	12,72	41,60	42,00
Stationery and printing	91	89	1,04	1,33
Miscellaneous and scientific departments	1,90	5,57	6,42	6,72
Total	22,98	22,67	1,07,73	1,10,43
	8.0	6.0	15.4	14.6
IV. Receipts from social services—				
Education	1,33	2,14	3,23	3,11
Public health	81	1,20	1,27	1,92
Total	2,14	3,34	4,50	5,03
	0.7	0.9	0.6	0.7
V. Others—				
Interest	43	2,36	4,43	4,55
Military receipts . . . .	..	..	..	..
Exchange . . . .	..	..	..	..
Superannuation	33	66	87	96
Miscellaneous	14,97	21,23	21,92	24,96
Total	15,73	24,25	27,21	30,47
	5.5	6.5	3.9	4.0
Total non-tax revenue	40,85	50,26	1,39,44	1,45,93
	14.2	13.4	19.9	19.3
Grand total	2,87,70	3,75,85	7,01,32	7,57,44
	100.0	100.0	100.0	100.0

¹ Land revenue was divided between the Central and Provincial Governments Hence the sudden increase in the figures for 1921-22 as compared with the previous

XVII

STATE REVENUE

GOVERNMENT OF MADRAS CLASSIFIED

and in Percentages.)

1914-15.	1915-16.	1916-17.	1918-19.	1919-20.	1920-21.	1921-22.
2,87,44 20,14 ..	2,95,48 20,37 ..	2,99,04 30,05 ..	2,92,86 40,25 ..	2,98,79 53,47 ..	2,89,91 69,97 ..	6,07,48 ¹ 39,89 ..
3,07,58 40.6	3,15,85 41.1	3,29,09 41.4	3,33,11 38.1	3,52,26 36.0	3,59,88 36.5	6,47,37 53.6
..
1,83,09	1,75,59	1,86,01	2,32,22	2,68,07	2,71,78	4,88,17
69,49 22,43	75,51 23,38	77,95 24,70	82,20 27,38	94,08 33,24	90,11 30,69	1,89,85 32,56
2,75,01 36.3	2,74,48 35.7	2,88,66 36.3	3,41,80 39.0	3,95,39 40.5	3,92,58 39.8	7,10,58 58.8
5,82,59 76.9	5,90,33 76.8	6,17,75 77.7	6,74,91 77.1	7,47,65 76.5	7,52,46 76.3	13,57,95 112.4
55,03 4.09	57,55 6.03	55,39 5.13	57,35 5.19	62,23 5.22	59,68 10.14	1,24,54 6.53
..
39,42 1.27	41,07 1.24	45,96 1.23	47,91 1.58	62,34 1.46	53,81 1.50	48,57 1.47
9.88	12.84	15.84	18.10	23.39	26.40	17.00
1,09,69 14.5	1,18,73 15.5	1,23,55 15.5	1,30,13 14.9	1,54,64 15.8	1,51,53 15.4	1,98,11 16.4
3.23 1.52 4.75 0.6	3.10 1.39 4.49 0.6	3.54 1.59 5.13 0.7	3.80 3.82 7.62 0.9	6.07 3.38 9.45 1.0	10.59 8.16 18.75 1.9	7.23 3.85 11.08 0.9
4.43	4.52	4.83	4.90	4.99	5.36	6.20
..
1.05	1.21	1.27	1.80	1.99	1.76	3.74
54.84 60.32 8.0	48.42 54.15 7.1	42.26 48.36 6.1	55.27 61.97 7.1	58.78 65.76 6.7	56.57 63.64 6.4	-3,69,41 -3,59,47 -29.7
1,74,76 23.1	1,77,37 23.2	1,77,04 22.3	1,99,72 22.9	2,27,85 23.5	2,33,96 23.7	-1,50,28 -12.4
7,57,35 100.0	7,67,70 100.0	7,94,79 100.0	8,74,63 100.0	9,77,50 100.0	9,86,42 100.0	12,07,67 100.0

prior to 1921-22. Since 1921-22 it is an entirely provincial head of revenue year.

TABLE
PROVINCIAL OR
GROSS REVENUE OF THE PROVINCIAL
(In Thousands of Rupees)

Heads of Revenue.	1891-92.	1901-2.	1911-12.	1913-14.
<i>A. Tax Revenue.</i>				
I. Direct—				
Land revenue	1,14,02	87,49	2,54,42	2,14,52
Income tax	21,54	28,26	27,88	33,19
Provincial rates	45,25	48,18	40,57	1,31
Tributes from States	1,80,81	1,63,93	3,22,87	2,40,02
Total	31.3	33.2	48.8	40.1
II. Indirect—				
Opium	1,11	..	..	..
Salt	27,83	75,13	1,45,71	1,53,89
Excise	57	2,65	..	..
Customs	1,13,25	1,42,54	81,69	1,09,55
Stamps	6,67	8,35	12,98	20,16
Registration	1,49,43	2,28,67	2,40,38	2,83,06
Total	25.9	46.4	36.3	45.6
Total tax revenue	3,30,24 57.2	3,92,60 79.6	5,63,25 85.1	5,82,62 85.7
<i>B. Non-Tax Revenue.</i>				
III. Government undertakings—				
Railways	1,60,40	..	..	..
Irrigation	25,38	24,53	16,80	4,00
Other public works	4,05	4,84	6,19	6,00
Posts and telegraphs . . . .	..	..	..	..
Mint . . . .	..	..	..	..
Forests	3,95	6,46	11,22	16,16
Stationery and printing	1,57	1,39	1,24	1,38
Scientific departments	1,96	2,76	2,40	2,78
Total	1,97,31 34.1	39,98 8.1	37,85 5.7	30,62 4.9
IV. Receipts from social services—				
Education	5,95	7,05	6,82	8,11
Public health	1,47	2,08	3,38	4,20
Total	7,42 1.3	9,13 1.9	10,20 1.5	12,31 2.0
V. Others—				
Interest	1,18	3,31	7,20	4,30
Military receipts . . . .	..	..	..	..
Exchange . . . .	..	..	..	..
Superannuation	1,27	71	66	39
Miscellaneous	40,58	47,52	42,92	41,17
Total	43,03 7.4	51,54 10.4	50,78 7.7	45,86 7.4
Total non-tax revenue	2,47,76 42.8	1,00,65 20.4	98,83 14.9	88,79 14.3
Grand total	5,78,00 100.0	4,93,25 100.0	6,62,08 100.0	6,21,41 100.0

¹ Land revenue was divided between the Central and Provincial Governments Hence the sudden increase in the figures for 1921-22 as compared with the previous

XVIII

STATE REVENUE

GOVERNMENT OF BENGAL CLASSIFIED

and in Percentages.)

1914-15.	1915-16.	1916-17.	1918-19.	1919-20.	1920-21.	1921-22.
1,55,18 34,02 1,70	1,65,62 36,13 2,34	1,65,02 84,28 1,35	1,67,97 1,12,01 1,12	1,70,01 1,73,69 1,12	1,71,18 2,16,64 97	3,01,89 ¹ 93,00 ..
1,91,80 30-8	2,04,09 32-2	2,50,65 37-8	2,81,10 38-0	3,44,82 40-9	3,88,79 45-0	3,94,89 46-7
..
1,53,75	1,51,40	1,44,44	1,76,64	1,81,49	1,96,68	1,83,01
1,01,34 18,13 2,73,22 43-9	1,12,19 20,36 2,83,95 44-7	1,20,76 21,49 2,86,69 43-3	1,24,83 19,18 8,20,65 43-4	1,50,29 25,57 3,57,35 42-4	1,41,15 26,84 3,64,67 42-2	2,73,84 25,48 4,82,33 57-1
4,65,02 74-7	4,88,04 76-9	5,37,34 81-1	6,01,75 81-4	7,02,17 83-3	7,53,46 87-2	8,77,22 103-8
..	..	..	..	..	..	1,68
3,95 7,09	4,79 6,19	5,62 8,57	6,51 9,79	6,20 7,10	6,00 7,68	11,86 5,75
..
13,04 1,50 5,33 30,91 5-0	11,46 1,33 7,06 30,83 4-8	13,39 1,50 13,77 42,85 6-5	19,44 1,73 15,32 52,79 7-2	20,51 1,93 22,18 57,92 6-9	21,85 2,06 11,97 49,56 5-7	18,99 3,70 17,85 59,83 7-1
8,47 8,95 12,42 2-0	8,87 3,60 12,47 2-0	9,47 4,58 14,05 2-1	9,88 4,23 14,06 1-9	9,96 4,92 14,88 1-8	11,10 5,31 16,41 1-9	10,65 5,71 16,36 1-9
4,14	4,64	6,49	5,62	6,12	6,44	4,21
..
..
59	55	59	65	5	56	2,11
1,09,02 1,13,75 18-3	98,08 1,03,27 16-8	61,00 68,08 10-3	64,14 70,41 9-5	60,52 67,19 8-0	37,43 44,43 5-2	-1,15,24 -1,08,92 -12-8
1,57,08 25-3	1,46,57 23-1	1,24,98 18-9	1,37,26 18-6	1,39,99 16-7	1,10,40 12-8	-32,73 -3-8
6,22,10 100-0	6,34,61 100-0	6,62,32 100-0	7,39,01 100-0	8,42,16 100-0	8,63,86 100-0	8,44,49 100-0

prior to 1921-22. Since 1921-22 it is an entirely provincial head of revenue. year.

TABLE XIX
THE BURDEN OF TAXATION
TAXATION BEFORE AND AFTER THE WAR
(In other Countries)

Country.		Tax Revenue.			Increase Per Cent over 1913-14 in	
		Pre-War Year, 1913-14.	Post-War Year.	Increase Per Cent.	Cost of Living.	Wholesale Prices.
The United Kingdom—						
National . . .	£ millions	163.1	718 ^a	340	74 ^a	59 ^a
Local ^b . . .	"	92.6	197 ^a	113	..	..
Total . . .	"	255.7	915	258	..	..
India—						
Central and Provincial	Rs. Crores	77.25	135.30 ^c	75	63 ^d	85 ^d
Local ^e . . .	"	7.17	11.63 ^a	62	..	..
Total . . .	"	84.42	146.93	74	..	..
Canada—						
Dominion . . .	\$ millions	127	320 ^a	133	90 ¹³	65 ¹³
Provinces . . .	"	20 ¹⁰	45 ⁹	125	..	..
Local . . .	"	50 ¹³	115 ¹¹	130	..	..
Total . . .	"	197	480	144	..	..
Australia—						
Commonwealth	£ millions	16.6	49.7 ¹⁴	199	42 ¹⁷	65 ¹⁷
States . . .	"	6.3	17.8 ¹⁴	183	..	..
Local . . .	"	4.0 ¹⁸	11.8 ¹⁵	195	..	..
Total . . .	"	26.9	79.3	195	..	..
New Zealand—						
National . . .	"	5.9	15.6	164 ¹⁸	45 ²⁰	75 ²⁰
Local . . .	"	2.2	4.1 ¹⁹	86	..	..
Total . . .	"	8.1	19.7	143	..	..
The United States—						
Federal . . .	\$ millions	672.4	3208 ²¹	377	68 ²²	53 ²²
State . . .	"	306.0 ²³	875 ²³	186	..	..
Local . . .	"	1219.8 ²⁴	2395 ²⁵	96	..	..
Total . . .	"	2198.2	6478	195	..	..
France—						
National . . .	Fr. millions	3843	15830 ²⁷	313	231 ²⁹	319 ²⁹
Local . . .	"	1350	4000 ²⁸	198	..	..
Total . . .	"	5193	19830	283	..	..
Germany—						
National . . .	{ Gold marks millions }	...	4564 ³⁰	..	..	..
Japan—						
National . . .	Yen millions	400.3	842.9 ³¹	110	..	93 ³²
Local . . .	"	178.5	500.4 ³³	124	..	..
Total . . .	"	578.8	1343.3	132	..	..

^a Revenue from rates, tolls, dues, and duties (excludes Government contributions).

^b 1923-24.

^c 1921-22 for England and Wales, and 1918-19 for Scotland and Ireland.

^d Board of Trade Index Number Average for 1923.

^e 1921-22. ^f 1920-21.

^g Labour Office Index Number Average for 1922.

^h 1921-22. ⁱ 1919-20.

^j 1915-16. The total receipts in 1915-16 were nearly equal to those in 1913-14.

^k 1919-20.

^l Half of the tax revenue for 1919-20 has been taken, as exact figures were not available.

^m Average for 1922.

ⁿ 1921-22.

^o 1920-21.

^p A third of the figures for 1920-21 has been taken, as exact figures were not available.

^q Averages for 1922.

^r 1922-23.

^s 1921-22.

^t Averages for 1923.

^u 1922.

^v 1913.

^w 1920 (*Taxation and National Income*—Bulletin No. 55 of the National Industrial Conference Board—New York, U.S.A.).

^x *Ibid.*

^y 1920, *ibid.*

^z Averages for 1922 Bureau of Labour Index Numbers.

^{aa} 1923 *Statistique générale de la France*, January 1924, p. 154.

^{ab} Three times the figure for 1913 was taken, cf. *Economist*, 15.3.24.

^{ac} Averages for 1923.

^{ad} Budget Estimate, 1924-25.

^{ae} Estimates 1921-22.

^{af} 1920-21, *Financial and Economic Annual of Japan* (Finance Department, Tokyo), 1921.

^{ag} See note 17.

TABLE XX

THE BURDEN OF TAXATION

PER CAPITA TAXATION BEFORE AND AFTER THE WAR
(In various Countries.)

Country.	Currency of Country.	Taxation per Head.			
		Pre-War Years.		Post-War Years. ¹	
		In Currency of Country.	In Sterling.	In Currency of Country.	In Sterling.
The United Kingdom—			£ s. d.		£ s. d.
National	£	3.55	3 11 0	15.9	15 18 0
Local	"	2.01	2 0 2	4.16	4 3 2
Total	"	5.56	5 11 2	20.06	20 1 2
India—					
Central and provincial	Rupees	3.12	0 4 2	5.55	0 7 5
Local	"	0.3	0 0 5	0.48	0 0 7
Total	"	3.42	0 4 7	6.03	0 8 0
Canada—					
Dominion	Dollars	16.60	3 8 2	36.45	7 9 0
Provincial	"	3.0	0 12 5	5.1	1 1 0
Local	"	6.9	1 8 5	13.2	2 14 5
Total	"	26.5	5 9 0	54.75	10 4 5
Australia—					
Commonwealth	£	3.40	3 8 0	9.02	9 0 4
State	"	1.30	1 6 0	3.21	3 4 0
Local	"	0.9	0 18 0	2.17	2 3 8
Total	"	5.60	5 12 0	14.40	14 8 0
The Union of South Africa—					
Union	"	1.45	1 9 0	3.5	3 10 0
Provinces	"	0.24	0 4 9	0.59	0 11 9
Local	"	0.20	0 4 0	0.38	0 7 8
Total	"	1.89	1 17 9	4.47	4 9 5
New Zealand—					
National	"	5.5	5 10 0	12.40	12 8 0
Local	"	3.33	3 6 8	2.00	2 0 0
Total	"	8.83	8 16 8	14.40	14 8 0
United States of America—					
Federal	Dollars	6.3	1 7 11	32.76	6 14 9
States	"	2.8	0 11 7	8.94	1 16 9
Local	"	11.17	2 6 0	24.46	5 0 7
Total	"	20.27	4 5 6	66.16	13 12 1
France—					
National	Francs	84.5	3 7 0	403.8	5 18 2
Local	"	34.1	1 7 0	102.0	1 10 0
Total	"	118.6	4 14 0	505.8	7 8 2
Germany—					
National	Gold marks	31.3	1 10 8	81.34	4 1 4
Japan—					
National	Yen	7.50	0 15 4	15.06	1 10 9
Local	"	3.34	0 6 9	8.94	0 18 3
Total	"	10.84	1 2 1	24.00	2 9 0

NOTE.—These figures have been arrived at from the tax revenue of various countries given in Table XXI.

¹ For the years please refer to the footnotes to Table XXII.

TABLE XXI

THE BURDEN OF TAXATION

PER CAPITA TAXATION IN VARIOUS COUNTRIES ALLOWING FOR PRICES¹

(Adapted from *Taxation and National Income*—Bulletin No. 55 of the National Industrial Conference Board, New York, U.S.A.)

Fiscal year. ^a	United Kingdom.	United States.	France.	Italy.	Germany.	Japan.	India.
	£	£	£	£	£	£	£
1902-03	4.8	3.6	3.4	2.0	2.4 ³	0.6	0.3
1912-13	5.4	4.7	4.4	2.5	3.8	1.1	0.3
1913-14	5.6	4.7	4.6	2.5	4.0	1.2	0.3
1914-15	5.9	4.9	3.9	2.1	4.1	1.2	0.2
1915-16	6.4	4.5	2.7	1.8	2.6	1.1	0.3
1916-17	7.9	4.0	2.4	1.8	2.7	1.0	0.3
1917-18	7.3	6.4	2.1	1.4	5.0	0.8	0.3
1918-19	8.6	6.5	1.8	1.6	4.2	0.9	0.3
1919-20	9.2	7.1	2.6	1.5	3.9	0.9	0.2
1920-21	9.5	8.3	3.1 ⁴	1.6	4.0	1.1	0.3

¹ Because of the paucity of sufficiently comparable data, no attempt has been made to take cognisance of the price changes prior to the World War, i.e. internal purchasing power was considered more or less stationary, with changes deemed relatively insignificant for the general purposes at hand. The figures for each year were divided by the index number of wholesale prices in each country in the same period in order to arrive at pounds of pre-War purchasing power.

² In the case of France, the fiscal year refers to the calendar year the major portion of which falls within the fiscal years of other governments, i.e. in the fiscal year 1902-3, the comparable fiscal year taken for France is 1902.

³ Fiscal year 1903-4.

⁴ In the calendar year 1921, which in this table corresponds to the 1921-22 of other countries, the *per capita* taxation on a pre-War purchasing power basis was £5.0.

The above figures generally include Central, Provincial or State and Local Governments as far as possible. The conversions from one currency to another have been at par of exchange.

TABLE XXII

THE BURDEN OF TAXATION

TAXATION AND NATIONAL INCOME

Country.		Pre-War Year 1913-14.			Post-War Year.		
		National Income.	Taxation.	Percentage of Taxation to National Income.	National Income.	Taxation.	Percentage of Taxation to National Income.
The United Kingdom	£ millions	2,250 ¹	..	..	3,900 ¹	..	..
National taxation	"	..	163.1	7.3	..	718	18.4
Local taxation	"	..	92.6	4.1	..	197	5.1
Total	"	..	255.7	11.4	..	915	23.5
India	Rs. crores	1,942 ¹	..	..	2,860 ¹	..	..
Central and provincial taxation	"	..	77.25	4.0	..	135.30	4.7
Local taxation	"	..	7.17	0.4	..	11.63	0.4
Total	"	..	84.42	4.4	..	146.93	5.1
Canada	\$ millions	1,500 ²	..	..	2,500 ²	..	..
Dominion taxation	"	..	127	8.4	..	320	12.8
Provincial taxation	"	..	20	1.3	..	45	1.8
Local taxation	"	..	50	3.3	..	115	4.6
Total	"	..	197	13.0	..	480	19.2

Australia	.	.	.	.	.	£ millions	258 ^s	..	6.4	..	430 ⁴	..	49.7	..	11.6
Commonwealth taxation	.	.	.	.	.	"	..	16.6	6.4	..	..	..	17.8	..	4.1
State taxation	.	.	.	.	.	"	..	6.3	2.5	..	..	..	11.8	..	2.7
Local taxation	.	.	.	.	.	"	..	4.0	1.5	..	..	..	79.3	..	18.4
Total	.	.	.	.	.	"	..	26.9	10.4	..	..	..	..	..	..
The United States	.	.	.	.	.	\$ millions	34,000 ^s	..	..	..	72,000 ^s	..	..	..	..
Federal taxation	.	.	.	.	.	"	..	672.4	2.0	..	..	..	3208	..	4.5
State taxation	.	.	.	.	.	"	..	306.0	0.9	..	..	..	875	..	1.2
Local taxation	.	.	.	.	.	"	..	1219.8	3.6	..	..	..	2395	..	3.3
Total	.	.	.	.	.	"	..	2198.2	6.5	..	..	..	6478	..	9.0 ¹¹
France	.	.	.	.	.	Fr. millions	37,500 ^e	..	..	..	140,000 ⁷	..	..	..	..
National taxation	.	.	.	.	.	"	..	3843	10.2	..	..	..	15830	..	11.3 ¹²
Local taxation	.	.	.	.	.	"	..	1350	3.6	..	..	..	4000	..	2.9
Total	.	.	.	.	.	"	..	5193	13.8	..	..	..	19830	..	14.2
Germany—National taxation	.	.	.	.	.	(Gold marks) (millions)	..	..	..	..	25,000 ⁸	..	4564	..	18.3
Japan	.	.	.	.	.	Yen millions	3,184 ⁹	..	..	..	6,145 ¹⁰	..	..	..	..
National taxation	.	.	.	.	.	"	..	400.3	12.6	..	..	..	842.9	..	13.7
Local taxation	.	.	.	.	.	"	..	178.5	5.6	..	..	..	500.4	..	8.1
Total	.	.	.	.	.	"	..	578.8	18.2	..	..	..	1343.3	..	21.8
Italy—National taxation	.	.	.	.	.	L. millions	20,200 ¹³	1732	8.6	..	103,000 ¹³	..	5947	..	5.8

¹ For details see Chapter XV.

² *Public Finance of the Dominion of Canada* (H. E. Fisk, Bankers' Trust Company, N. Y., 1922).

³ "Wealth and Income of the Chief Powers" (Stamp, *Journal of the Royal Statistical Society*, 1919).

⁴ "National Income and Taxation" (Bulletin No. 55, National Industrial Conference Board, N. Y.).

⁵ Cf. also Fisk, *French Public Finance* (B. T. Co.).

⁶ "Wealth and Income of the Chief Powers" (Stamp, *Journal of the Royal Statistical Society*, 1919).

⁷ This figure has been arrived at by multiplying the income for the pre-war year by the index number of wholesale prices.

⁸ The bulletin referred to in note 5 gives this as 12 per cent. for 1919 on p. 51. But taxation in the United States was especially high in 1919.

⁹ The *Economist*, March 15, 1924, puts this at 16 per cent. But it should be noted that the *Economist* takes (29,000 m. francs) whole revenue and not tax revenue alone.

¹⁰ *Inter-ally Debts*, p. 290 (Fisk, Bankers' Trust Company Publication, New York, 1924).

¹¹ *Economist*, April 5, 1924.

¹² Estimates.

¹³ One yen has been taken to be equal to 24½d.

TABLE XXIII
THE BURDEN OF TAXATION
TAXATION IN INDIA

Year.	Taxation.			Per Capita Taxation.		
	Central and Provincial.	Local.	Total.	Central and Provincial.	Local.	Total.
	1000 Rs.	1000 Rs.	1000 Rs.	Rs.	Rs.	Rs.
1891-92	58,02,61	4,00,03	62,02,64	2.9	0.2	3.1
1901-02	65,57,55	5,56,00	71,13,55	2.8	0.2	3.0
1911-12	78,37,96	7,36,99	85,74,95	3.2	0.3	3.5
1913-14	77,24,82	8,47,62	85,72,44	3.2	0.3	3.5
1914-15	75,24,20	8,78,01	84,02,21	3.1	0.4	3.5
1915-16	76,18,79	9,19,40	85,38,19	3.1	0.4	3.5
1916-17	87,95,49	9,64,48	97,59,97	3.6	0.4	4.0
1917-18	96,86,03	9,94,80	106,80,83	3.9	0.4	4.3
1918-19	100,96,14	10,52,97	111,49,11	4.1	0.4	4.5
1919-20	122,15,32	11,16,79	133,32,11	4.9	0.5	5.4
1920-21	129,85,38	11,63,43	141,48,81	5.3	0.5	5.8
1921-22	135,30,04	¹	¹	5.5	¹	¹

Not available.

TABLE XXIV

THE BURDEN OF TAXATION

DIRECT AND INDIRECT TAXATION IN VARIOUS COUNTRIES

	Great Britain.		India.		Canada.		Australia		New Zealand.		U.S.A.		France.		Italy.		Japan.	
	1913-14.	1922-24.	1913-14.	1921-22.	1913-14.	1921-22.	1913-14.	1921-22.	1913-14.	1922-24.	1913-14.	1921-22.	1913.	1922.	1913-14.	1922-24.	1913-14.	1921-22.
	Million £	Million £	Lakhs Rs.	Lakhs Rs.	Million \$	Million \$	Million £	Million £	Million £	Million £	Million \$	Million \$	Million Francs.	Million Francs.	Million Lire.	Million Lire.	Million Yen.	Million Yen.
<i>Direct Taxes.</i>																		
Land revenue	0-7	2-8	32.09	34.87	..	..	1-6	3-5	0-8	1-5	..	..	..	..	81-8	120-0	74-6	74-0
Income tax and super tax	47-2	330-0	2,92	25,12	..	177-5	26-3	0-6	3-8	..	2087-0	..	119	1,160	313-0	973-6	36-6	268-1
Estate, etc., duties	27-4	57-8	..	..	4-7	7-3	..	3-2	0-6	1-8	71-4	139-4	778	3,391	48-0	200-0	3-4	5-0
Capital levy	..	..	..	..	..	..	..	..	..	..	..	..	..	..	106-0	160-0	..	..
House duty	2-0	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..
Land value duties	0-7	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..
Excess profits duty	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..
Corporation profits duty	..	23-3	..	..	7-2	19-2	..	..	..	..	..	..	..	..	..	..	..	..
War-time tax	14-7	..	1-20	87	0-8	..	..	1-3	0-4	1-8	2-5	..	632	..	..	..	..	..
Other direct taxes	78-0	428-6	86.21	60.86	204-0	..	1-6	34-3	2-4	8-9	73-9	2226-4	1319	4,557	548-8	1453-6	113-6	347-1
Total direct taxes	47-8	59-7	46-9	45-0	8-6	53-9	9-6	50-8	40-7	57-0	11-0	69-4	39-5	28-8	31-7	24-5	28-4	41-2
<i>Indirect Taxes.</i>																		
Excise	39-6	148-0	20.94	29.62	21-5	36-8	2-3	10-3	3-4	6-0	306-2	521-8	678	1,995	210-2	575-0	140-9	253-2
Customs	35-5	120-0	11.34	32.56	104-7	105-7	12-7	17-3	0-1	0-7	292-3	357-5	625	1,609	266-7	73-7	73-7	90-9
Stamps	10-0	21-6	7.98	11.12	4-1	5-9	..	3-3	..	..	..	58-2	244	697	85-0	300-0	30-8	70-4
Registration	..	..	78	1-14	3-8	12-5	..	..	..	..	..	..	..	..	96-5	400-0	..	..
Business tax	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	27-4	48-7
Turnover tax	..	..	..	..	..	..	..	..	..	..	..	..	..	3,016	..	..	..	..
Entertainments tax	..	..	..	..	..	..	..	0-7	..	..	..	..	760	3,667	524-7	3218-0	..	..
Monopolies	..	..	..	..	..	..	..	1-6	..	..	..	44-2	17	296	..	..	13-9	32-6
Other indirect taxes	85-1	289-6	41.04	74.44	134-1	160-9	15-0	33-2	3-5	6-7	598-5	981-7	2324	11,280	1183-1	4493-0	2867	495-8
Total indirect taxes	52-2	40-3	53-1	55-0	91-4	44-1	90-4	49-2	59-3	43-0	89-0	30-6	60-5	71-2	68-3	75-5	71-6	58-8
Grand total tax revenue	163-1	718-2	77.25	135.30	146-8	364-9	16-6	67-5	5-9	15-6	672-4	8208-1	3843	15,837	1731-9	5946-6	400-3	842-9
	100-0	100-0	100-0	100-0	100-0	100-0	100-0	100-0	100-0	100-0	100-0	100-0	100-0	100-0	100-0	100-0	100-0	100-0

TABLE XXV
PUBLIC DEBT BY COUNTRIES (Millions of Pounds Sterling)

Country.	1713.	1763.	1793.	1816.	1848.	1870.	1889.	1900.	1913 (Pre-War).	Post-War.		Per Capita.			
										Year.	Debt.	1913.		Post-War Year.	
												£	s.	£	s.
The British Empire—															
Great Britain . . .	54	147	370	900	773	801	698	629	706	1923-24	7,766	15	8	174	2
India . . .				29	51	108	186	226	307	1921-22	585	10	7	174	2
Canada . . .					5	37	49	55	69	1922-23	500	10	8	55	10
Australia . . .							171	204	335	1922-23	923	53	14	64	10
New Zealand . . .									48	1919	219	58	12	162	13
South Africa . . .						2	27	..	126	1921-22	179	..	..	116	19
Foreign countries—															
U.S.A. . .	48	110	17	26	10	485	221	259	245	1921-22	4,715	3	8	42	6
France . . .			32	140	260	504	1269	1086	1315	1922-23	11,472	28	4	356	0
Germany . . .				39	69	148	435	448	1055	1919	9,850	2	2	139	0
Italy . . .				25	36	333	460	586	611	"	3,124	18	0	17	12
Belgium . . .					25	28	77	105	185	"	784	15	4	21	8
Austria . . .	10	15	42	99	125	340	580	358	510	"	3,470	13	17	..	..
Spain . . .	7	11	20	117	113	285	260	433	382	1923	478	24	1	19	10
Holland . . .				110	114	76	89	97	97	1924	286	18	18	13	5
Japan . . .						10	50	53	272	1921-22	323	1	4	6	12
Russia . . .				145	90	342	756	656	1046	1917	3,415	5	2	18	14
Portugal . . .			47	145	90	342	756	656	1046	1917	3,415	5	2	18	14
Denmark . . .			1	17	22	59	113	177	130	1922-23	525	35	0	87	0
Norway . . .			2	12	12	13	11	11	20	"	66	4	17	20	0
Sweden . . .						6	20	10	20	"	66	4	17	20	0
Switzerland . . .								16	36	"	70	3	12	32	2
Greece . . .								3	68	1919	148	6	10	13	8
Rumania . . .					10	18	23	39	48	1922	316	15	19	35	4
Serbia . . .							13	16	27	1919	445	8	11	57	9
Czecho-Slovakia . . .										"	234	7	2	25	13
Hungary . . .								185	270	"	388	1	587	..	..
Poland . . .										"	1,557	9	14	..	..
Bulgaria . . .										"	440	218	15	12	..
Turkey . . .						92	180	170	35	1919	218	9	18	22	0
Egypt . . .						37	103	103	151	1923	412	7	11	29	0
Argentina . . .									94	"	93	10	12	7	5
Latvia . . .								103	124	1919	127	24	14	16	19
Finland . . .										"	127	24	14	16	19
China . . .								55	130	"	174	12	14	16	19
Chile . . .									33	"	172	12	14	16	19
Siam . . .									6	"	7	12	14	16	19
Brazil . . .								82	194	"	180	12	14	16	19
Total . . .	119	283	610	1,649	1,719	3,741	5,827	6,263	8,805	..	53,759	..	..	..	..
No. of countries . . .	4	4	10	12	17	21	23	29	33	..	..	..	..	..	..

The various currencies have been converted into sterling at par of exchange, e.g. \$4.867 = £1, or 25.235 Fr. = £1.

TABLE XXVI.—PUBLIC DEBT OF THE GOVERNMENT OF INDIA (CENTRAL AND PROVINCIAL)

Year ending 31st March.	Debt in India.			Debt in England.			Total Liabilities.			Productive Debt.				Per Head.		
	Permanent. ¹	Term. posnary. ¹	Per- manent. ¹	Term. posnary. ¹	Per- manent. ¹	Other Li- abilities.	In India.	In England.	Total.	Railways.	Irriga- tion and other Works.	Total Pro- ductive (Col. 11).	Ordinary. ² (Col. 12).	Total Debt (Col. 9).	Pro- ductive (Col. 12).	Ordinary (Col. 13).
1.	2.	3.	4.	5.	6.	7.	8.	9.	10.	11.	12.	13.	14.	15.	16.	17.
1882	Lakhs Rs. 88.65	Lakhs Rs. 68.14	Lakhs Rs. 10.13	Lakhs Rs. 10.13	Lakhs Rs. 10.13	Lakhs Rs. 10.13	Lakhs Rs. 68.14	Lakhs Rs. 10.13	Lakhs Rs. 10.13	Lakhs Rs. 10.13	Lakhs Rs. 10.13	Lakhs Rs. 10.13	Lakhs Rs. 10.13	Lakhs Rs. 10.13	Lakhs Rs. 10.13	Lakhs Rs. 10.13
1883	102.69	102.69	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1884	102.94	102.94	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1885	105.55	105.55	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1886	104.97	104.97	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1887	108.79	108.79	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1888	109.12	109.12	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1889	111.70	111.70	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1890	112.65	112.65	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1891	112.47	112.47	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1892	115.33	115.33	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1893	116.19	116.19	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1894	117.55	117.55	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1895	119.42	119.42	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1896	122.30	122.30	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1897	125.08	125.08	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1898	130.58	130.58	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1899	134.57	134.57	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1900	137.53	137.53	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1901	138.84	138.84	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1902	139.96	139.96	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1903	142.84	142.84	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1904	145.69	145.69	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1905	150.52	150.52	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1906	155.46	155.46	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1907	162.86	162.86	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1908	170.08	170.08	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1909	179.37	179.37	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1910	184.44	184.44	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1911	189.10	189.10	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1912	193.96	193.96	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1913	198.84	198.84	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1914	203.62	203.62	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1915	208.50	208.50	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1916	213.38	213.38	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1917	218.26	218.26	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1918	223.14	223.14	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1919	228.02	228.02	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1920	232.90	232.90	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1921	237.78	237.78	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1922	242.66	242.66	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1923	247.54	247.54	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13
1924	252.42	252.42	10.13	10.13	10.13	10.13	107.40	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13	10.13

The above figures have been compiled mostly from the Finance and Revenue Accounts of the Government of India, published by the Finance Department of the Government of India.
 * Includes Treasury Bills sold to the public and the paper currency reserve and loans from the Imperial Bank of India.
 * Includes Initial Capital expenditure on new capital at Delhi.

* Subject to correction.
 * Central Government only.

TABLE XXVII
ANALYSIS OF THE PUBLIC DEBT OF VARIOUS COUNTRIES

Country.	Popula- tion. Millions.	Year.	Currency.	Internal Debt.	External Debt.	Funded Debt.	Unfunded Floating Debt.	Other Liabilities.	Total Debt.	Proportion of				
										Internal Debt.	External Debt.	Funded Debt.	Unfunded Debt.	
The British Empire—														
Great Britain	44.2	1923-24	Million £	6,615	1,151	6,921	774	71	7,766	85.1	14.9	89.1	10.9	
India	247.0	1923-24	Crores of Rs.	484	393	732	52	73	877	55.1	44.9	85.7	14.3	
Canada	8.8	1921-22	Million \$	2,483	419	2,420	482	..	2,902	85.6	14.4	83.4	16.6	
Australia	5.4	1921-22	"	792	131	883	29	11	923	85.8	14.2	95.7	4.3	
New Zealand	1.3	1922-23	"	106	113	..	..	..	219	48.4	51.6	..	..
Union of South Africa	7.1	1920-21	"	56	123	158	21	..	179	31.0	69.0	88.3	11.7	
Foreign countries—														
The United States	109.2	1921-22	\$	22,904	..	15,965	6,999	..	22,964	87.7	12.3	69.5	30.5	
France	39.2	1922-23	Fr.	253,834	35,538	186,521	102,851	..	289,372	99.0	1.0	64.4	35.6	
Germany	59.9	1921	M.	302,204	3,149	76,644	228,709	..	305,353	81.1	18.9	25.1	74.9	
Italy	38.8	1921	Lire	90,780	27,246	76,308	35,718	..	112,026	90.5	9.5	45.4	54.6	
Belgium	7.5	1921	Fr.	27,740	2,880	13,850	16,770	..	30,620	92.4	7.6	..	..
Spain	21.3	1922	P.	11,028	918	..	..	..	11,946	64.5	35.5	..	..
Japan	58.7	1922-23	Yen	2,450	1,359	..	..	..	3,809	55.7	44.3	77.1	22.9
Holland	6.9	1922	Florins	3,560	..	2,745	815	..	3,560	77.5	22.5	94.7	5.3	
Denmark	3.3	1921-22	Kronor	608	535	1,203	..	..	1,203	64.0	36.0	72.1	27.9
Sweden	5.9	1921	"	1,171	340	1,433	78	..	1,511	..	..	..	..
Norway	2.6	1921	"	782	434	880	336	..	1,216	..	..	..	..

TABLE XXVIII
RATIO OF DEBT TO ORDINARY REVENUE

Countries.	Pre-War Year, 1913-14.	Post-War Year.	
		Year.	Ratio.
Great Britain	3·6	1923-24	9·3
India	3·6	1921-22	3·6
Canada	2·1	"	6·3
Australia	6·2	"	6·2
New Zealand	8·2	1922-23	8·2
South Africa	7·9	1921-22	6·2
The U.S.A.	1·6	"	5·6
France	6·9	1922	11·9
Italy	5·1	"	6·6
Belgium	4·6	1923	12·7
Japan	4·5	1921-22	2·6
Germany	2·0	1920-21	5·7
Spain	7·0	1922-23	4·0
Austria	1·4	"	2·7
Portugal	7·4	"	10·2
Denmark	2·7	"	2·8
Sweden	1·5	1924	2·1
Norway	1·1	1922-23	2·5
Greece	5·2	1922	2·6
Holland	5·0	1924	5·4
Switzerland	3·8	1922	17·4

TABLE XXIX

THE BURDEN OF DEBT

PROPORTION OF EXPENDITURE ON DEBT SERVICES TO TOTAL
ORDINARY EXPENDITURE

Country.	Pre-War Year, 1913-14.	Post-War Year.	
	Percentages.	Year.	Percentages.
Great Britain	12.2	1923-24	39.0
India ¹	12.2	1921-22	15.0
Canada ²	10.9	"	33.5
Australia ³	"	1922-23	23.8
New Zealand	23.5	"	33.8
South Africa	38.8	1920-21	28.6
The United States ⁴	3.2	1921-22	44.2
France	13.5	1924	53.8
Germany	7.3	1922-23	13.0
Belgium	27.1	1923	31.8
Japan	36.9	1921-22	18.4
Austria	Not available	1923	10.5
Spain	29.0	1922-23	21.8
Sweden	8.4	1923-24	12.2
Norway	12.5	"	11.4
Switzerland	8.9	1924	38.6
Netherlands	16.4	1923	30.6

¹ Central and Provincial.² Dominion and Provinces.³ Commonwealth and States.⁴ Federal.

TABLE XXX

PAYMENTS DUE ANNUALLY BY GREAT BRITAIN ON ACCOUNT OF DEBT
TO THE UNITED STATES

(In Dollars—000,000 omitted.)

Year.	Principal.	Interest.	Total.	Year.	Principal.	Interest.	Total.
1923	23-0	138-0	161-0	1954	64-0	119-6	183-6
1924	23-0	137-3	160-3	1955	64-0	117-4	181-4
1925	24-0	136-6	160-6	1956	64-0	115-1	179-1
1926	25-0	135-9	160-9	1957	67-0	112-9	179-9
1927	25-0	135-2	160-2	1958	70-0	110-5	180-5
1928	27-0	134-4	161-4	1959	72-0	108-1	180-1
1929	27-0	133-6	160-6	1960	74-0	105-6	179-6
1930	28-0	132-8	160-8	1961	78-0	103-0	181-0
1931	28-0	131-9	159-9	1962	78-0	100-2	178-2
1932	30-0	131-1	161-1	1963	83-0	97-5	180-5
1933	32-0	131-9	183-9	1964	85-0	94-6	179-6
1934	32-0	150-8	182-8	1965	89-0	91-6	180-6
1935	32-0	149-7	181-7	1966	94-0	88-5	182-5
1936	32-0	148-5	180-5	1967	96-0	85-2	181-2
1937	37-0	147-4	184-4	1968	100-0	81-9	181-9
1938	37-0	146-1	183-1	1969	105-0	78-4	183-4
1939	37-0	144-8	181-8	1970	110-0	74-7	184-7
1940	42-0	143-5	185-5	1971	114-0	70-8	184-8
1941	42-0	142-1	184-1	1972	119-0	66-8	185-8
1942	42-0	140-6	182-6	1973	123-0	62-7	185-7
1943	42-0	139-1	181-1	1974	127-0	58-4	185-4
1944	46-0	137-7	183-7	1975	132-0	53-9	185-9
1945	46-0	136-0	182-0	1976	136-0	49-3	185-3
1946	46-0	134-4	180-4	1977	141-0	44-6	185-6
1947	51-0	132-8	183-8	1978	146-0	39-6	185-6
1948	51-0	131-0	182-0	1979	151-0	34-5	185-5
1949	51-0	129-3	180-3	1980	156-0	29-2	185-2
1950	53-0	127-5	180-5	1981	162-0	23-8	185-8
1951	55-0	125-6	180-6	1982	167-0	18-1	185-1
1952	57-0	123-7	180-7	1983	175-0	12-2	187-2
1953	60-0	121-7	181-7	1984	175-0	6-1	181-1
Total .				4,600-0	6,505-8	11,105-8	

TABLE XXXI

COST OF THE WAR

THE COST OF THE WAR—ENTIRE PERIOD COVERING THE SIX FISCAL YEARS, 1914 TO 1919 INCLUSIVE
(In Pounds—000,000 omitted.)

Nations.	Total Expenditure.	Normal Expenditure.	Direct Cost.	Loans to Allies.	Gross Cost.	Deduct Loans from Allies.	Net Cost.
<i>Allied and Associated Powers.</i>							
The British Empire—							
Great Britain	11,076.0	964.0	8,310.1	1,801.9	10,112.0	1,110.1	9,001.9
Australia	476.7	112.6	364.1	..	364.1	33.3	330.8
Canada	782.7	242.5	476.9	43.4	520.3	1.6	521.9
India	687.1	475.0	212.0	..	212.0	..	212.0
New Zealand	234.4	120.4	114.0	..	114.0	26.5	87.5
Union of South Africa	159.0	118.4	40.7	..	40.7	11.5	29.2
Crown Colonies	182.0	140.5	41.5	..	41.5	..	41.5
Total British Empire	13,577.9	2,173.4	9,559.3	1,845.3	11,404.6	1,179.8	10,224.8
Belgium	411.8	127.0	284.8	578.8	6,894.8	1,108.9	5,785.9
France	7,926.2	1,031.4	6,316.0	..	67.0	58.4	8.6
Greece	115.1	48.0	67.0	..	3,828.2	803.6	3,024.6
Italy	4,432.7	604.5	3,828.2	..	115.9	..	115.9
Japan	419.1	803.3	141.5	..	141.5	18.6	122.9
Portugal	235.3	93.7	115.9	..	224.3	84.8	139.5
Rumania	308.8	84.4	224.3	..	4,099.9	744.9	3,355.0
Russia	5,312.7	1,212.0	4,039.9	60.0	89.4	80.4	7.435.0
Servia	119.0	36.6	89.4	..	7,516.5	81.5	80,212.2
U.S.A.	8,103.0	586.5	5,559.9	1,956.6	31,060.9	4,454.7	2,752.0
Total Allies	40,963.6	6,296.7	30,226.2	4,440.7	..	205.5	66.2
Central Powers—							
Austria Hungary	4,068.4	1,111.0	2,957.5	..	2,957.5	97.8	9,666.7
Bulgaria	261.0	97.0	164.0	..	164.0	..	117.3
Germany	10,341.1	674.3	9,246.1	420.6	260.3	420.6	12,627.9
Turkey	451.8	191.5	260.3	..	13,048.5	4,875.3	42,840.1
Total Central Powers	15,122.3	2,073.8	12,627.9	420.6	47,715.4	..	..
Grand Total	56,085.9	8,370.6	42,854.1	4,861.3	..	..	..

Adapted from *Inter-ally Delta*. By H. E. Fisk. Bankers' Trust Company, N.Y., 1924.

TABLE XXVII
NATIONAL WEALTH OF THE CHIEF COUNTRIES

Country.	Year.	National Wealth.	In Sterling at Par.	In Sterling at Current Rate of Exchange.	Current Rate of Exchange.
Great Britain	1923	£20,000 millions	..	£20,000 millions	..
Canada	1923	\$25,000 "	£5,100 millions	£5,400 "	4 465 \$=1 £
India	1922	Rs. 15,000 crores	£10,000 "	£10,000 "	15 Rs. to the £
The U.S.A.	1923	\$355,000 millions	£72 900 "	£81,200 "	4 87 \$ to the £
France	1923	Fr 1,200,000 millions	£47,600 "	£14,400 "	82 88 Fr. to the £
Italy	1923	L. 611,000 "	£24,222 "	£6,100 "	100 15/32 L.=1 £

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